

Closing the gap

Addressing imbalances in global finance



Policy Paper

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CIDSE 
together for global justice
ensemble pour un monde de justice
juntos en pro de la justicia global

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LIST OF ACRONYMS

CPIA	Country Policy and Institutional Assessment
CPI	Corruption Perception's Index
CSR	Corporate Social Responsibility
CST	Catholic Social Teaching
CTDL	Currency Transaction Development Levy
CTT	Currency Transaction Tax
DAC	Development Assistance Committee (OECD)
ECOSOC	Economic and Social Council (United Nations)
EITI	Extractive Industries Transparency Initiative
EPAs	Economic Partnership Agreements
EU	European Union
FATF	Financial Action Task Force (G8)
FDI	Foreign Direct Investment
FTT	Financial Transaction Tax
GATT	General Agreement on Tariffs and Trade
GNI	Gross National Income
GDP	Gross Domestic Product
HIPCs	Heavily Indebted Poor Countries
IBCs	International Business Corporations
IFIs	International Financial Institutions
IFRS	International Financing Reporting Standards
ILO	International Labour Office
IMF	International Monetary Fund
LICs	Low Income Countries
MDGs	Millennium Development Goals
PWYP	Publish What You Pay
OECD	Organisation for Economic Cooperation and Development
ODA	Official Development Assistance
OFCs	Offshore Financial Centres
OTC	Over-the-Counter
ROSCs	Reports on Observance of Standards and Codes
SPVs	Special Purpose Vehicles
StAR	Stolen Assets Recovery (Initiative)
TJN	Tax Justice Network
TNCs	Trans-national Corporations
UN	United Nations
UNCAC	UN Convention Against Corruption
UNFCCC	UN Framework Convention on Climate Change
UNODC	UN Office on Drugs and Crime
UNU-WIDER	United Nations University - World Institute for Development Economics Research
VAT	Value Added Tax
WIFO	Austrian Institute of Economic Research
WTO	World Trade Organisation

NB: All figures indicated in \$ are US\$.

EXECUTIVE SUMMARY

In the last decade, a net transfer¹ of financial resources from poor to rich countries has developed and steadily increased. From a balance of \$46 billion in favour of developing countries in 1995, it turned into a negative balance of \$658 billion in 2006 (including economies in transition)². It recently turned negative even for Sub-Saharan African countries in spite of relatively higher aid inflows into the region. Reasons behind this global trend are that neither aid flows, foreign direct investment nor remittances compensate for massive debt repayments, trade imbalances, capital flight and the accumulation of foreign assets, especially foreign exchange reserves like in China³.

In comparison to debt, trade, aid and investment, taxation has been the subject of very little attention by the international development community. In this paper, CIDSE sets down detailed arguments, for issues of capital flight, tax competition and systems of taxation to be put at the heart of the development agenda. Recommendations on how this can be done follow the arguments.

The main arguments:

- Taxation serves important functions that contribute to development. These could be summarised as the 5 'Rs': Revenue, Redistribution, Regulation, Re-pricing, Representation.
- Just distribution of wealth and power is at the heart of international Catholic Social teaching, which forms the basis of CIDSE's advocacy. This stems from the recognition of the dignity of every individual and the consequent need to work to build a world where all without exception can live a fully human life. It also stems from the belief in the universal recognition of the earth's goods which requires that all other rights whatsoever including those of property and of free commerce are to be subordinated to this principle. Thirdly it stems from the principle of the preferential option for the poor which considers that a sound political organisation must ensure that defenceless individuals are given special care and concern and are the focus of particular intervention of government authority. Translated into practice, it is the citizen's duty to support the common good not only through charity but also by paying taxes as an act of solidarity.
- The amounts of money that are lost due to a failure of a development-approach to taxation are considerable. The Tax Justice Network estimated in 2005 that wealthy individuals alone hold \$11.5 trillion offshore, creating tax losses of \$255 billion⁴. This includes legal and illegal forms of tax evasion and avoidance, but excludes tax abuse by corporations, which may be much larger.
- Globalisation has contributed to the weakening of national tax systems. Women have been particularly affected by this impact. They constitute the majority of the poor globally. They are dependent to a great extent on public services often weakened by falling tax revenues. The global quest to reduce poverty (so far most manifested in the Millennium Development Goals - MDGs), cannot be de-linked from the fight against inequality. Cooperation at the international level to ensure that tax systems, whether national or across borders, combat widening inequality with a global perspective is crucial.
- The weakening of multilateral economic institutions has opened a new era of uncertainty. It has allowed for more autonomy among strong emerging powers. But countries on a weaker footing remain the losers in unfair bilateral deals, with the consequent unleashing of forces that lead to the regression of national tax systems. The weak global governance system is

¹ Net transfers refer to net capital inflows less net interest and other investment income payments.

² UN DESA (2007) *World Economic Situation and Prospects, 2007*. New York: United Nations Department of Economic and Social Affairs. <http://www.un.org/esa/policy/wess/wesp2007files/wesp2007.pdf>.

³ When China buys dollars to build foreign currency reserves, financial flows are considered negative for China and positive for the USA. <http://www.jubileeresearch.org/news/SNFinFloGKN1a.pdf>.

⁴ http://www.taxjustice.net/cms/front_content.php?idcat=103.

unable to effectively address this situation. Decisive global action to end tax erosion needs to be undertaken by legitimate and strong international institutions.

- Current tax systems based on the nation state face increasing constraints due to the mobility of capital and activities of trans-national corporations (TNCs). Tax competition, reduced regulation and a shift of taxation from capital to labour and consumption are the consequence. A multi-layered approach to the problem is required. These would include increased cooperation for transparency and regulation of capital; putting in place mandatory codes for sustainable and transparent management of resources; holding businesses accountable to a binding human rights framework for their activities and integrating tax responsibility into concepts of corporate social responsibility.
- The growing openness of financial markets, cross-border investments and shopping around for the use of the most convenient technical facilities have seen the booming of tax havens, also known as secrecy jurisdictions. Tax havens are detrimental to development. First of all due to the losses of revenue that would rightfully be put to public use. They provide a shelter for stolen assets of dictators, autocrats, corrupt officials and agents who undermine law and order. In the current financial crisis, one dangerous characteristic of tax havens has been underlined: the secrecy and complex financial arrangements that they offer have allowed the concealment of excessive risks that companies have taken, leading to uncertainty in the financial markets. The current financial crisis has brought these shadowy players into the spot-light leading to a momentum that needs to be seized by political leaders to end the detrimental behaviour of such jurisdictions.
- The commodity and food crises, the implications of climate change and the current financial crisis pose dramatic threats especially to vulnerable groups. Action to address their impact has also opened discussions on international taxes as a means to regulate their impact and raise additional finance. While the issue of international taxation is not in anyway new, it is important to capitalise on current discussions to implement them.

Recommendations

1. Progressive and gender-sensitive national tax systems should be at the heart of democratic national development financing strategies combined with regional coordination

Tax systems have to be tailored to respond to each national context and be seen to be responsive to public needs. They should seek the right balance between, individual and corporate taxes, direct and indirect taxation, taxes on labour and wealth, exemptions, subsidies and broad inclusion in the tax system.

2. Donors must support building or reinforcing progressive national taxation systems

In the long run developing countries should depend less on aid resources but gradually build up and manage their own sources of income. This would first and foremost mean that countries should have the policy space to define their own tax policies suitable for their situation and the needs of their citizens. For donors now concentrating on budget support to developing countries this would mean stepping up support to developing countries in establishing transparent financial systems and accountable institutions and encourage participatory budgeting processes as well as gender budgeting.

3. The international fight against tax evasion and competition should be made a development priority

Efforts to build up and sustain progressive taxation systems will be severely hampered if the international community does not work towards an enabling financial and economic environment that plugs the leaks of capital flight, tax evasion or competition and corruption. Limiting tax competition, tax evasion and the harmful operations of offshore financial centres (OFCs) needs serious international cooperation on various levels including:

- i. A greater role for the UN in the area of tax cooperation
- ii. A code of conduct for states on cooperation in combating international tax evasion and avoidance

- iii. Strengthened judicial and tax cooperation
- iv. Limiting tax competition
- v. Generalising the legal responsibility of people promoting or undertaking tax evasion
- vi. Underlining the responsibility of the International Monetary Fund (IMF) for the monitoring and surveillance of financial centres and the international financial architecture
- vii. Supporting vulnerable economies in moving away from tax haven status

4. A range of measures must be taken to enhance the transparency of revenues of TNCs

Civil society mobilisation has been developing strongly to demand greater revenue transparency. Many CIDSE agencies are part of the international Publish What You Pay campaign calling for mandatory disclosure by oil, gas and mining companies.⁵ Some initiatives have developed such as the Extractive Industries Transparency Initiative (EITI), the European Parliament's motion on country-by-country reporting by the extractive industry and similar initiatives in the US Senate. However, initiatives have to be extended to all economic sectors. CIDSE recommends that:

- Country by country reporting be made applicable to all industries. If country-by-country reporting could be applied to International Financial Reporting Standards (IFRS), it would capture almost all of the world's major multinational companies.
- -The OECD black list should also target the key users of tax havens, including banks and transnational companies. Sanctions should be taken against the companies which maintain subsidiaries in uncooperative tax havens and which refuse to provide details and explanation of their links with those territories. Such sanctions could include prohibiting the access to public command, public export credit and even the access to the stock exchange.
- An international trade register is created– or at least regional registers, in particular at the European Union (EU) level – in order to keep track of all created companies and legal entities, especially special purpose vehicles (SPVs) and trusts, including the name of shareholders and/or beneficial owners. This would much facilitate the work of tax administrations and the judiciary and would contribute to end the phenomenon of shell companies.

5. Global taxes must be adopted as a viable response to scale up redistribution and respond to emerging global challenges

In the current context, global taxation has the potential to fulfil at global level such key functions as revenue raising, redistribution and re-pricing. The creation of international taxes could also potentially accelerate the much needed strengthening of democratic global institutions with some sense of representation. CIDSE particularly advocates the adoption of a Currency Transaction Tax (CTT), or a more general Financial Transaction Tax (FTT).

⁵ <http://www.publishwhatyoupay.org/about>

INTRODUCTION

Taxation as a development priority

For many decades the financing for development debate has focussed exclusively on official development assistance (ODA). Yet ODA constitutes only a small share in the Financing for Development equation for many developing countries. Since 2000, OECD countries' ODA have amounted to an average of \$75 billion per year.

Meanwhile, in the last decade, a net transfer⁶ of financial resources from poor to rich countries has developed and steadily increased. From a balance of \$46 billion in favour of developing countries in 1995, it turned into a negative balance of \$658 billion in 2006 (including economies in transition)⁷. It recently turned negative even for Sub-Saharan African countries in spite of relatively higher aid inflows into the region. Reasons behind this global trend are that neither aid flows, foreign direct investment nor remittances compensate for massive debt repayments, trade imbalances, capital flight and the accumulation of foreign assets, especially foreign exchange reserves like in China⁸. Among those flows, debt and trade have pointedly been the subject of much international debate, as evidenced by their being specific pillars in the Monterrey Consensus. CIDSE and others have actively contributed to the debate on the unsustainable dimension of debt from a human development approach.⁹ Based on studies done in Malawi, Mozambique, Tanzania and Uganda before the big multilateral debt reduction package announced at the Gleneagles G8 Summit in 2005, it was estimated that as much as a quarter of domestic revenue of these countries was diverted into debt servicing which otherwise would have been available for financing the MDGs¹⁰. The risks associated with trade liberalisation have also been largely criticised by NGOs, especially regarding agriculture and services.¹¹ An IMF Working Paper from 2005 also found that low-income countries have failed to recover from domestic sources such revenue as they have lost from trade reform¹².

The building up of foreign currency reserves has two aspects. It may be an effective, though very costly way for developing countries to reduce their vulnerability to external shocks and financial crises and their dependency towards the IMF. At the same time it contributes to global imbalances.

In comparison to debt, trade, aid and investment, illicit capital flight has received very little attention from the international development community. This is all the more surprising as the amounts at stake are considerable. Precise estimates are hard to come by: the offshore world is hard to define, and shrouded in a pervasive culture of secrecy. In addition, many of the most egregious abuses involve domestic taxation issues (often impacted harmfully by tax competition and other aspects of the international financial system). Several estimates of the magnitude of the problem have been made.¹³ It is hard to build up a global picture because of the fragmented nature of the different estimates, and the fact that they overlap each other. Some important estimates include:

⁶ Net transfers refer to net capital inflows less net interest and other investment income payments.

⁷ United Nations Department of Economic and Social Affairs (UN DESA) (2007), *World Economic Situation and Prospects, 2007*, New York - <http://www.un.org/esa/policy/wess/wesp2007files/wesp2007.pdf>.

⁸ When China buys dollars to build foreign currency reserves, financial flows are considered negative for China and positive for the USA - <http://www.jubileeresearch.org/news/SNFinFloGKN1a.pdf>.

⁹ See for instance, CIDSE (2007), *A Human Development Approach to Preventing New Cycles of Debt*, Brussels.

¹⁰ Kapoor M, Kapoor S (2005), *Financing Development Towards the MDGs What Needs to be Done?*, Heinrich Böll Foundation North America.

¹¹ See for instance, CIDSE (2005), *Justice not Charity: Policy Recommendations to Donors ahead of the G8 Summit 2005*, Brussels.

¹² Baunggaard, Thomas and Keen, Michael (2005), *Tax Revenue and (or?) Trade Liberalization*, IMF Working Paper, Washington DC.

¹³ See a range of estimates assembled by TJN - http://www.taxjustice.net/cms/front_content.php?idcat=103.

- Raymond Baker, in the book “*Capitalism’s Achilles Heel*”, estimated that cross-border illicit flows of money range between \$1.1-1.6 trillion annually, about half from developing and transitional economies. According to Baker, out of this considerable \$500 billion to \$800 billion, 3 per cent stems from corruption, 30 to 33 per cent from criminal activities and approximately 65 per cent from tax evasion. In other words, tax evasion would cost developing countries between \$300 billion and \$520 billion. This is worth up to ten times of ‘real aid’.

In September 2007, the UN Office on Drugs and Crime (UNODC) and the World Bank endorsed Baker’s figure, although they have not yet published their own independently researched data. According to them: “*the cross-border flow of the global proceeds from criminal activities, corruption, and tax evasion is estimated at between \$1 trillion and \$1.6 trillion per year*”¹⁴.

Baker broke down his figures as follows:

Cross-border flows of global dirty money, \$ billion, annual	Low	High
Criminal	331	549
Corrupt	30	50
Commercial, of which:	700	1,000
<i>Mispricing</i>	200	250
<i>Abusive transfer pricing</i>	300	500
<i>Fake transactions</i>	200	250
TOTAL	1,061	1,599

- In 2005 the Tax Justice Network estimated that wealthy individuals alone hold \$11.5 trillion offshore, creating tax losses of \$255 billion¹⁵. This includes legal and illegal forms of tax evasion and avoidance, but excludes tax abuse by corporations, which may be much larger.
- UK academic, Alex Cobham, estimated the tax loss for developing countries to be \$385 billion¹⁶. Of this \$285 billion is due to the informal sector (he estimates that the formalisation of the informal sector would reasonably bring about an additional \$113 billion in public income), \$50 billion is sheltered offshore and \$50 billion is linked to corporate transfer mispricing.
- In May 2008 Christian Aid published a report in which the mere cost of mispricing strategies and fake invoicing would represent a conservative \$160 billion a year loss to developing countries¹⁷.

One cannot but agree with the World Bank assertion that “*the theft of public assets from developing countries is a huge and serious problem*”. What remains striking though are the negligible efforts undertaken by international development institutions to counteract this massive global theft of the poorest countries.

Taxation better finances development

Beyond the figures regarding the plunder of public assets from developing countries, which undeniably need to be refined by further academic research, the international community needs to take into account the nature and the combination of resources to finance development. Sociology suggests there is no grant without a return to the donor¹⁸. The gift also places the donor in a superior position vis-à-vis the recipient which is placed in a position of dependency under the donor. History confirms how misguided it would be to consider financing for development as a mere needs-fulfilment exercise.

¹⁴ *Stolen Assets Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan*, September 2007.

¹⁵ http://www.taxjustice.net/cms/front_content.php?idcat=103.

¹⁶ *Tax Evasion, Tax Avoidance and Development Finance*, Queen Elizabeth House Working Paper Series No. 129, Oxford, 2005.

¹⁷ *Death and taxes, the true toll of tax dodging*, May 2008.

¹⁸ Mauss M., *An essay on the gift: the form and reason of exchange in archaic societies*, *Année Sociologique* 1923-1924.

A long-term perspective tends to show that the capacity of a state to fulfil its obligations towards its citizens not only depends on its historical trajectory but also on the nature of its resources:

- In many Southern countries the state is the relatively recent inheritance from colonial power. Democratic processes were subsequently weakened by various forms of foreign interferences in the Cold War context. Such strategies of domination, by countries like the US in Latin America and France in Africa, helped many corrupt and despotic regimes to hold power.
- British academic Mick Moore's historical research¹⁹ highlights the close relation between what he calls "*political development*", i.e. democratisation, and public income. He found that those states that have put in place a sophisticated administration to collect taxes tend to become more accountable to their people and provide them with essential services, security and justice. On the contrary, the more a state depends on what he calls "*unearned income*", i.e. resources that do not require much administrative effort to collect, such as oil and other natural resources, the less it tends to serve its citizens. Such guaranteed revenues rather encourage the development of authoritarian regimes. The state then becomes an attractive target for domestic or foreign rent-seekers, such as so-called *war-lords*, neighbouring countries or trans-national mining companies. Similarly, a high dependency upon external assistance can encourage governments to be accountable to their foreign donors rather than to their own constituency. Paradoxically, aid may thus become damaging to the development of democracy. The history of Southern countries' indebtedness can only confirm this observation. Many Southern people developed an acute sense of having been deprived of their sovereignty by their international creditors. The often denounced economic conditionalities of the World Bank and the IMF that have been associated with development assistance and debt relief have indeed prevented many governments in Asia, Latin America and Africa, over the last few decades, from designing the policies expected by their citizens.

As an international network of Catholic development organisations advocating for wealth to be distributed more equally within and among countries, CIDSE considers that taxation should be at the heart of development finance.

At its onset, this paper discusses how Catholic Social Teaching (CST) and the preferential option for the poor provide a strong basis to advocate in favour of tax justice. Chapter two argues that rapid global changes while proving to significantly challenge existing tax systems, have also created opportunities for a renewed tax justice consensus. The paper finally makes some recommendations which could serve as stepping stones towards international tax justice.

¹⁹ See in particular Moore, Mick (1997), *Death without taxes: aid dependency, democracy and the fourth world*, Institute of Development Studies (IDS), Sussex University, February 1997 and Moore, Mick (1999) *Taxation and political development*, IDS, June 1999. See also: <http://www2.ids.ac.uk/gdr/cfs/pdfs/Wp280.pdf> - <http://taxjustice.blogspot.com/2008/01/how-to-build-state.html> - http://www.aei.org/publications/pubID.27798/pub_detail.asp.

I. JUST DISTRIBUTION OF WEALTH AND POWER AT THE HEART OF CATHOLIC SOCIAL TEACHING

1.1 Dignity and human development

Dignity of all and every man and woman is at the heart of Catholic social thinking. The ultimate goal is *“building a world where every man, no matter what his race, religion or nationality, can live a fully human life, freed from servitude imposed on him by other men or by natural forces over which he has not sufficient control; a world where freedom is not an empty word”* (Populorum Progressio, 47). Freedom from servitudes would imply that human needs must not go unsatisfied. Therefore the poor should be provided with realistic opportunities to live dignified lives.

Catholic Social teaching conceives dignity and freedom as both an individual and a collective imperative. *“World unity, ever more effective, should allow all peoples to become the artisans of their destiny. The past has too often been characterized by relationships of violence between nations”* (Populorum Progressio, 65). As evidenced above, excessive dependence on external resources can be a form of servitude for a country. On the contrary, the mobilisation of domestic resources, in particular taxes, favours national autonomy.

1.2 The universal destination of the earth’s goods

Already in Rerum Novarum (1893), while proclaiming the right to private ownership, Pope Leo XIII also affirmed that the *“use”* of goods, while marked by freedom, is subordinated to their original common destination as created goods. Ever since, the Church has repeatedly insisted on both the legitimacy of private ownership and its limits. *“God intended the earth and all that it contains for the use of every human being and people. Thus, as all men follow justice and unite in charity, created goods should abound for them on a reasonable basis”* (Gaudium et Spes, 69, 1).

The encyclical Populorum Progressio (22) is also very clear on this: *“All other rights whatsoever, including those of property and of free commerce, are to be subordinated to this principle”*. Quoting St John (3: 17) *“If someone who has the riches of this world sees his brother in need and closes his heart to him, how does the love of God abide in him?”* and Saint Ambrose: *“You are not making a gift of your possessions to the poor person. You are handing over to him what is his. For what has been given in common for the use of all, you have arrogated to yourself. The world is given to all and not only to the rich”* (De Nabuthe, c. 12, n. 53), Paul VI concluded that *“No one is justified in keeping for his exclusive use what he does not need, when others lack necessities (...). The right to property must never be exercised to the detriment of the common good.”* (Populorum Progressio, 23). He then calls on *“the responsibility of public authorities to look for a solution”* to conciliate private property rights and the necessary redistribution. More recently in Centesimus Annus (30), John Paul II also stressed, after Gaudium et Spes (69, 71), that *“private property also has a social function which is based on the law of the common purpose of goods”*.

Catholic Social Teaching thus questions in depth current mainstream economic thinking, which tends to consider private property as an absolute right and taxes as a cost to society.

1.3 Preferential option for the poor

Jesus taught: *“whatsoever you do to the least of these, my brothers and sisters, you do unto me”* (Matthew, 25: 40). At times of globalisation, the fate of the poorest in the world thus becomes the indicator of our common humanity. Development and social justice are also believed to ultimately serve us all: *“The advancement of the poor constitutes a great opportunity for the moral, cultural and even economic growth of all humanity.”* (Centesimus Annus, 28).

Stemming from that very principle, John-Paul II reiterates what he presents as “*an elementary principle of sound political organization, the more that individuals are defenceless within a given society, the more they require the care and concern of others, and in particular the intervention of governmental authority.*” (Centesimus Annus, 10)

He goes on explaining that “*the State cannot limit itself to “favouring one portion of the citizens,” namely the rich and prosperous, nor can it “neglect the other,” which clearly represents the majority of society. (...) The defenceless and the poor have a claim to special consideration. The richer class has many ways of shielding itself, and stands less in need of help from the State; whereas the mass of the poor have no resources of their own to fall back on, and must chiefly depend on the assistance of the State.*”

This whole principle gives a sound basis for a strong taxation system with a view to providing basic services to the poor and redistributing wealth among people.

1.4 Guidelines for tax justice

It is the citizens’ duty to support the common good not only through charity but also by paying taxes as an act of solidarity. Pope Paul VI’s words sound like a challenge to the many individuals and private companies seeking to escape paying taxes: “*Let each one examine his conscience, a conscience that conveys a new message for our times. Is he prepared to support out of his own pocket works and undertakings organized in favour of the most destitute? Is he ready to pay higher taxes so that the public authorities can intensify their efforts in favour of development?*” (Populorum Progressio, 47). A reasonable and fair system of taxation has to be established according to the “*ability to pay*” and the needs to be covered (Gaudium et Spes, 30²⁰).

The State should mobilise resources and ensure their prudent use under democratic scrutiny to fulfil several objectives:

- Ensure the provision of public services for all in order to fulfil human needs and enable all human beings to realise their potentials (in line with the rationale behind the rapid achievement of the MDGs).
- Fostering redistribution to counteract inequalities and global imbalances and end discrimination. Special attention needs to be given to the poor, especially women, the marginalized and groups with special needs. As a matter of justice this calls for progressive tax systems as well as exemptions for those below poverty line.
- Regulate where market forces fail.
- Preserve common goods, especially regarding the human and natural environment.
- Use the potential of international co-operation and solidarity for the benefit of mankind.

Catholic social teaching emphasizes the crucial role of taxation to achieve these goals for every civic and political community²¹.

The call Pope Paul VI made to public officials more than 40 years ago is therefore still relevant today, at a time when many governments multiply tax exemptions for the rich: “*Government officials, it is your concern to mobilize your peoples to form a more effective world solidarity, and above all to make them accept the necessary taxes on their luxuries and their wasteful expenditures, in order to bring about development and to save the peace*” (Populorum Progressio, 84).

²⁰ Gaudium et Spes, 30: “*Obligations of justice and love are fulfilled only if each person, contributing to the common good, according to his own abilities and the needs of others, also promotes and assists the public and private institutions dedicated to bettering the conditions of human life*” - http://www.vatican.va/archive/hist_councils/ii_vatican_council/documents/vat-ii_const_19651207_gaudium-et-spes_ge.html.

²¹ Compendium of the Social Doctrine of the Church, 355.

In the context of increased internationalization, many obligations go beyond the capacity of the nation state to fulfil the responsibility to finance global public goods. When poverty and exploitation affect an immense number of people, taking “*on the proportions of a true worldwide social issue*”²², the Church stresses the need for such structural answers as organised international solidarity, provision of global funds and international regulation. This intimately relates to ongoing international debates and initiatives regarding global taxation.

II. TAXATION IN A CHANGING WORLD: CHALLENGES AND OPPORTUNITIES

Taxation is generally said to fulfil several main functions, which closely relate to those identified in the spirit of Catholic Social Teaching. These are 5 ‘Rs’:

- Revenue: taxes provide public funds to finance public policies.
- Redistribution: taxes can reduce poverty and inequality both by its use for the benefit of the poorest and by its progressive structure (where the percentage tax rate increases as the income rises).
- Regulation: tax policy can be a key element of economic policy.
- Re-pricing: tax can allow all social costs of production (e.g. environmental costs) and consumption (e.g. cost of certain goods on health) to be reflected in the market price of goods and services.
- Representation: in providing taxes citizens somehow give a mandate to their representatives to use public funds in a responsible and accountable manner. It thus strengthens channels of representation.

National systems of taxation face various global challenges that put into question their key functions. Some of these challenges are examined below along with some opportunities to overcome them.

- 1) Increasing inequality versus MDG commitments
- 2) Imposed tax losses versus more autonomy for Southern governments
- 3) Maximizing profit versus raising CSR agenda
- 4) Tax havens, tax evasion and corruption versus transparency and regulation

2.1 Increasing inequality versus MDG commitments

2.1.1 Financing MDG achievement

With inequality taking on dramatic proportions, both within and between countries, social and economic rights are the subject of growing social mobilisation and international commitments.

2.1.2 Inequality between and within countries

The distribution of wealth as such is almost as old a problem as humankind is. It is quite clear for instance that tax injustice was at the very root of the decline of the Roman Empire. Salvien, a priest in Marseilles in the 5th century, indeed argued that the people had no incentive to fight for the Empire. Similarly, the French Revolution was largely due to raising discontent by the bourgeoisie who paid significant taxes for the benefit of tax exempted nobility. The abolition of privileges, in the night of the 4th of August 1789, was much motivated by the refusal of any tax privilege. The expression “Third

²² Compendium of the Social Doctrine of the Church; 208.

World” was coined by French geographer, Alfred Sauvy, after the ‘*Third State*’ of the French Revolution, i.e. the powerless majority.

Inequalities between states have dramatically increased in the 20th century. Global wealth is held by a few and highly concentrated in the North: the richest 2 per cent of adults in the world own more than half of global household wealth, according to a recent UNU-WIDER study on the world distribution of wealth²³, while the poorest half of the world’s adult population own barely 1 per cent of global wealth. On an average, US citizens own 100 times more than Indonesians. Almost all of the world’s richest individuals live in North America, Europe, and rich Asia-Pacific countries, whereas African countries, India and low-income Asian countries make up for the bottom third. With the exception of China that has been catching up with the rest of the world, the inequality gap between countries has been increasing²⁴. The UN MDG Report 2007 reported that between 1990 and 2004, the share of national consumption by the poorest fifth of the population in developing regions decreased from 4.6 per cent to 3.9 per cent. Regionally, it reports that inequality remains the highest in Latin America and the Caribbean and in Sub-Saharan Africa, where the poorest fifth of the people account for only about 3 per cent of national consumption or income.²⁵

High inequality has not only developed between countries, but as well - with variations - within countries. While in the USA the top 10 per cent possess 70 per cent of assets against a share of less than 3 per cent for the lowest half of the population according to the UNU WIDER study, wealth in China is more equally distributed with the richest 10 per cent owning 41 per cent compared to 14 per cent share of the lowest half. According to the study inequality in wealth distribution is much higher than income inequality. Inequality is also rising within countries, such as in Eastern Asia, where the lowest fifth on the economic ladder is consuming less: from 7.3 per cent in 1990 to 4.5 per cent in 2004.

2.1.3 Inequality between social groups

Globalisation also impacts differently on different social groups. Empirical evidence²⁶ shows that *rural poor* in developing countries gain or lose from openness of markets depending on whether they are net sellers or buyers of tradable goods, the latter being the situation of the majority in poor countries. Besides, rural poor will have to cope with the effects of the overexploitation of fragile environmental resources, e.g. deforestation and scarcity of water resources, often occurring as side effects of trade liberalisation and export orientation.

2.1.4 Inequality between women and men

Women are disproportionately affected by globalisation as they constitute the majority of the poor, Women depend to a great extent on public services that have been weakened by globalisation. They therefore carry the burden of failing social services. Furthermore, there are high numbers of women who are subsistence and small scale farmers. They are in charge of fuel and water provisions for the household and encounter the constraints posed by environmental degradation to a considerable extent.

Gender-differentiated property-ownership analysis suggests that women face greater constraints than men in accumulating and keeping assets. Yet wealth distribution patterns between men and women can have decisive impact on poverty reduction measures. Owning assets can help mitigate vulnerability and improve women’s welfare, productivity, equality and empowerment²⁷. Distribution

²³ Davies J, Sandstorm S and Wolff E (2008), *The World Distribution of Household Wealth* UNU WIDER.

²⁴ Chotikapanich D., Prasada Rao D.S., Griffiths W.E., Valencia V. (2007), *Global Inequality: Recent Evidence and Trends*, UNU WIDER Research Paper No. 2007/01, 2007.

²⁵ United Nations (2007), *The Millennium Development Goals Report 2007*, New York.

²⁶ See: Nissanke M, Thorbecke E. (2007) *Linking Globalization to Poverty*, UNU-WIDER Policy Brief No. 2.

²⁷ Deere C.D., Doss C.R. (2006), *Gender and the Distribution of Wealth in Developing Countries*, UNU WIDER Research Paper No. 2006/115.

of assets between men and women eventually affects household expenditure patterns on food, health, education and household services and thus influences the outlook for children.

2.1.5 Inequality and development

Inequality leads to poverty traps passed on over generations if no counteractive measures are taken, a recent World Bank research confirms. The World Bank report on “*Equity and Development*”²⁸ also warns about risks involved with unequal power relations leading to a perpetuation of inequalities in power, status and wealth with detrimental effects in investment and growth, which they see as precondition for reducing poverty. In an environment like this, the benefits of liberalisation will be captured by the rich and influential, as evidenced by the cases of Mexico and Russia.

Growing inequality represents a real challenge for the redistribution function devoted to taxes. At national level, tax structures tend to be less and less progressive. At the international level, there are no international taxes so far that could organise a global system of redistribution.

2.1.6 The rationale behind the MDG commitments

"We will have time to reach the Millennium Development Goals – worldwide and in most, or even all, individual countries – but only if we break with business as usual. We cannot win overnight. Success will require sustained action across the entire decade between now and the deadline. It takes time to train the teachers, nurses and engineers; to build the roads, schools and hospitals; to grow the small and large businesses able to create the jobs and income needed. So we must start now. And we must more than double global development assistance over the next few years. Nothing less will help to achieve the Goals."

United Nations Secretary-General Kofi A. Annan, July 2005

There has been a simultaneous historical trend towards the recognition and the fulfilment of economic and social human rights. In the past, the international community elaborated brilliant declarations such as the Universal Declaration on Human Rights, the 60th anniversary of which will be commemorated a few days after the International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, also known as the Doha Review Conference in December 2008, or the Optional Protocol for Economic, Social and Cultural Rights in 1968 that was finally adopted by the eighth session of the UN Human Rights Council in June 2008. Unfortunately, those conventions could not, by themselves, make the rights they proclaimed a universal reality. Since the UN World Summit for Social Development in Copenhagen in 1995 and most importantly the Millennium Summit in 2000, the international community has adopted a more pragmatic approach.

The Millennium Development Goals (MDGs) are not entirely satisfactory.²⁹ But their most important achievement is the timeline they provide to significantly reduce poverty and hunger at the national and international levels. These goals along with the more vaguely used ‘*internationally agreed development goals*’ have been repeatedly endorsed by Member States of the UN as well as by every international institution. The timeline set for the MDGs has taken on an almost binding character, if not legally then at least morally, thus conveying a huge potential for change.

This could become all the more powerful in the medium to long term. One cannot seriously believe that the international community would be entirely satisfied after (hopefully) halving poverty in 2015

²⁸ World Bank (2005), *Equity and Development*, World Development Report 2006.

²⁹ CIDSE (2005), *More than a Numbers Game, Ensuring the Millennium Development Goals address Structural Injustice*, Brussels.

in comparison with 1990, and leaving aside the other half of the world's poor. The rationale behind the MDGs, as outcome-based poverty reduction commitments of the international community, is likely to be stronger even than the MDGs themselves and to last well beyond 2015.

2.1.7 Financing MDG achievement

By focusing on measurable targets in a given timeframe, the MDGs also raise the key question of the means for them to be achieved. Little progress has been made in this area, as evidenced by the UN Millennium Development Report 2007³⁰ (See Box 1 below).

Box 1: ODA fails to finance development aspirations

Since 2000, OECD countries' ODA have amounted to an average of \$75 billion per year. Much of this aid is inflated. It is generally estimated that only a part of this amount (which we call 'real aid') actually is used in developing countries for their development priorities. In the European Union non-aid items such as debt relief, costs for foreign students and refugees accounted for €8 billion, making up 17 per cent of all European ODA in 2007. Additionally much of the money that is left for development is also so fragmented to have little real impact. In a report released in 2008, the OECD DAC revealed that 15 or more donors were collectively providing less than 10 per cent of a country's total aid in the case of 24 countries receiving aid in the year 2005-2006.

Limited progress has been made to achieve the modest Millennium Development Goals. These internationally recognised goals were developed by the UN in 2000 and aimed to halve absolute poverty globally by 2015. The lack of political will to uphold financing commitments is not new. Almost 40 years ago, most rich countries committed to dedicate 0.7 per cent of their Gross National Income (GNI) to ODA. In 2002, the Monterrey Consensus and the G8 Africa Action Plan repeated that no country would fail to achieve the MDGs through a lack of finance. Yet, with the exception of a handful of Nordic countries that have constantly dedicated up to 1 per cent of their national wealth to international solidarity, donors have failed their promises.

Compared to 2002 levels when ODA was \$58 billion, volumes increased in 2005 (\$107.1 billion) and 2006 (\$104.4 billion). The increases were due to large Paris Club debt relief operations for Iraq and Nigeria. With the end of high debt relief figures in 2007, total ODA of OECD countries fell by 8.4 per cent to \$103.7 billion. (Source: OECD-DAC, April 2008).

With these short-falls, donors have displayed considerable eagerness to look at 'aid effectiveness.' While efficient use of resources is also a priority for CIDSE, donors may well be focussing on aid quality to find reasons not to increase aid quantity. They have also shown considerable imagination in adding new categories of expenditure in the calculation of ODA. The definition of ODA has already been widened to include debt reduction, financing the education of foreign students and some expenses incurred in hosting refugees. Other categories for inclusion in ODA calculations that are de facto included or up for discussion are actions to combat climate change (see Outcome of G8 Summit 2008) and peacekeeping expenditures (see, for instance, Haas M de and Beerthuisen M, *Financing of Peacekeeping Operations- A benchmark study*, The Hague Netherlands Institute of International Relations, Clingendael 2008). Some countries such as the USA do also promote alternative indicators of broader national contribution to development, including private aid, migrant remittances and private foundation donations.

Only one out of the eight regional groups is on track to achieve all the Millennium Development Goals, the projected shortfalls being most severe in Sub-Saharan Africa, which is not on track to meet any of the MDGs. Positive results are also in danger of being counteracted by the dramatic rise in oil and food prices worldwide, the global financial crisis, and the threat of an economic recession in the United States with its probable negative impact on the rest of the world.

The means to finance the MDGs was the primary reason for the International Conference on Financing for Development held in Monterrey, Mexico in 2002. At the Millennium+5 World Summit of the UN,

³⁰ United Nations (2007), *The Millennium Development Goals Report 2007*, New York.

in September 2005, raising the necessary resources for financing the MDGs remained a major issue. It boosted the debate on innovative mechanisms for financing development, such as international taxes. At the mid-term of the MDG timeline, in July 2007, UN Secretary General Ban Ki Moon reminded donors of their obligations and called on them to establish timetables for increasing their contributions. The Doha Review Conference provides another opportunity to remind every actor of its responsibilities. This is an opportunity to foster the debate on taxation. The provision of the basic services that are necessary to fulfil the MDGs is a key function of taxes. So far though, tax issues have barely been included in the Financing for Development debate, mainly for political reasons. In 2001, the Zedillo Report was commissioned by the UN Secretary General to recommend financing strategies for achieving the MDGs and played an important role in defining the agenda of the first International Financing for Development Conference in Monterrey in 2002. This Report included a strong focus on the tax issue. Yet, mainly due to the opposition of OECD countries, domestic taxation was only mentioned under one of the six pillars of the Monterrey Consensus, namely '*mobilisation of domestic resources*'. As for international taxes, they keep on being a taboo in the UN language due to US and others' stiff opposition to the idea, but the reference to '*innovative sources of financing*' or voluntary '*contributions*' was deemed acceptable in the Outcome Declaration of the World Summit in 2005.

Given the centrality of taxation in any development financing strategy, the issue will necessarily come back on the agenda. The sooner, ideally at the Doha Review Conference, the better.

2.1.8 Conclusion

For CIDSE, the provision of basic services to fulfil fundamental human rights, starting with the basics committed to in the MDGs need to be guaranteed by predictable and sound sources of public finance, taxation being the first of them. At the same time, the international community should not delink the fight against poverty from the fight against inequalities, since poverty is also a relative notion. CIDSE recommends that national tax systems be more favourable to the poor and calls for the creation of an international tax system to combat widening international inequalities.

2.2 Imposed tax losses versus more autonomy for Southern governments

2.2.1 Externally driven tax losses

Tax policy formulation is not only a domestic issue for most developing countries. The considerable influence of their colonial history on the development of their fiscal systems aside, there are also more recent external factors that have influenced current tax policies of many developing countries, especially in Africa. Over the last few decades, aid conditionality and the trade liberalisation agenda have deeply fashioned the tax system in many of these countries.

2.2.2 Role of International Financial Institutions policy advice

During the debt crisis in the early 1980s, the IMF, as part of their Structural Adjustment Programmes, imposed huge obligations for tax reform on indebted countries to avoid any chances of their defaulting on debt repayments regardless of the progressive character of targeted tax structures. On the contrary, evidence suggests that the IMF has been promoting the systematic implementation of regressive VAT regardless of its distributional impact³¹. Structural Adjustment Programmes not only weakened redistributive mechanisms but also the state capacity to regulate the economy, i.e. two key functions of taxation. In parallel, IMF and World Bank programmes led to trade and finance liberalisation, thereby depriving many countries of revenues that normally came from tariffs, a crucial source of income.³² In

³¹ Damme, Lauren, Misrahi, Tiffany and Orel, Stephanie (2008), *Taxation Policy in Developing Countries What is the IMF's Involvement?*, Consultancy Paper for The Bretton Woods Project, April 2008.

³² *International Finance, Tax Competition and Offshore Financial Centers* - http://www.idrc.ca/en/ev-67839-201-1-DO_TOPIC.html.

Cameroon for instance, tariffs accounted for 56 per cent of tax revenues in 1992, against 35 per cent in 2000. The GATT and then the WTO agreements furthered this trend. The dependence on trade taxes is even greater in post-conflict fragile states, e.g. they provide 60 per cent of total government revenue in Sierra Leone³³. Even worse, these policies have been imposed in the form of conditionality for loans, debt relief or aid on developing countries leaving them little space for policy choice and thereby undermining the local accountability of their governments. This is especially true about the World Bank, whose annual “Doing Business” report, as well as its Country Policy and Institutional Assessment (CPIA) index which the multilateral development banks and some bilateral donors base their financing decisions on, rank developing countries’ attractiveness for foreign direct investment (FDI) depending in particular on their tax policy.

Countries which chose not to strictly implement the externally driven (or imposed) policy advice were relatively less affected. It is widely acknowledged that some Asian countries in particular have taken more advantage of globalisation having controlled the pace and the extent of their trade and financial liberalisation to a considerable extent.³⁴

2.2.3 Increased mobility of capital and TNCs

Globalisation of trade and finance allowed trans-national companies and rich individuals to invest where they could pay less tax, thus providing a major incentive for acute tax competition between jurisdictions. Amid fierce tax competition, which affects both developed and developing nations, the tax rates and tax burdens on capital are steadily lowered, meaning that tax has to shift to less mobile factors such as labour and consumption. The net result is a very large increase in inequality, both between nations and within nations.

Developing economies try to attract foreign investment by granting tax holidays or tax reductions, establishing free trade zones and free movement of revenues outside the country thus leaving little benefits behind and discriminating against local business. This is evidenced worldwide by consistent figures: in Europe, corporate taxes lowered from approximately 50 per cent in the 1970s to 32.5 per cent in 1999 and 29.8 per cent in 2003. Since 1994, the Republic of South Africa has lowered its corporate tax rates from 48 per cent to 30 per cent. The small neighbouring island of Mauritius offers less than 1 per cent corporate tax rates. ILO estimates the number of free trade zones to be 2700 today in more than 100 countries as against 79 in 1975 within only 25 countries³⁵.

Simultaneously, many tax exemptions are offered to attract foreign investors, in particular via the multiplication of free trade zones. In a report in August 2008, the IMF correctly noted: *“Tax incentives in Sub-Saharan Africa are now used more widely than in the 1980s, with more than two-thirds of the countries in the region providing tax holidays to attract investment. The number of countries using free zones that offer tax holidays has also dramatically increased. Moreover, low-income countries in the region use such incentives more extensively than do middle-income countries—yet foreign direct investment in Sub-Saharan Africa, other than in the resource sector, has increased very little over the past two decades. Such incentives not only shrink the tax base but also complicate tax administration and are a major source of revenue loss and leakage from the taxed economy.”*³⁶

This analysis confirms what various civil society organisations in Africa and Latin America denounce - e.g. according to the Christian organization, Juventud Obrera Cristiana in Nicaragua: *“In Nicaragua,*

³³ Therkildsen, Ole (2008), *Taxation and state-building with a (more) human face*, DIIS Policy Brief, October 2008.

³⁴ Wang J. (2005), *Financial Liberalization in East Asia: Lessons from Financial Crises and the Chinese Experience of Controlled Liberalization*.

³⁵ Singa Boyenge, Jean-Pierre (2006) *Base de données du BIT sur les zones franches d’exportation*”, ILO.

³⁶ Sanjeev, Gupta and Shamsuddin, Tareq (2008) *Mobilizing Revenue: strengthening domestic revenue bases is key to creating fiscal space for Africa’s developmental needs*, IMF Finance & Development Quarterly, September 2008 - <http://www.imf.org/external/pubs/ft/fandd/2008/09/gupta.htm>.

in Central America and in 80 other countries in the world, the impact of free trade zones is the same: the setting of enclaved economies with tax exemptions and where companies can operate with low social, labour and infrastructure costs and with no environmental and social constraints³⁷..”

2.2.4 Tax exemptions for international development actors

Donors have also been one of the primary beneficiaries of tax exemptions. For instance, the World Bank and the IMF require a tax exemption on VAT on import and personal income tax for both its foreign and local employees, as well as for foreign employees of its contractors. UN agencies require the exemption of the profit tax for its foreign contractors only, while USAID asks for the same exemption for its local contractors only. As the Danish researcher, Ole Therkildsen, puts it, developing countries’ states “*are often forced to administer a myriad of exemptions, which (...) places unnecessary burdens on the already weak tax authorities and promotes corruption. Even worse, it fuels a tax-exemption culture, and sends a wrong signal that the powerful may succeed in escaping taxation.*”³⁸

2.2.5 Development impact of falling revenue

The development impact of these externally driven tax revenue losses has been dramatic. It has led to reduced budget space for investment in basic social services or increased dependency on external financing. Foreign producers and trans-national businesses have enjoyed favourable conditions while local producers and small entrepreneurs have been deeply affected in many countries, particularly in Africa and Latin America. Taxation on labour or indirect taxes such as Value Added Tax (VAT) and fees are making up an increasing share of tax revenue. While there is a lack of gender-differentiated analysis of tax structures and public expenditure, the obvious conclusion is that poor and women in particular end up carrying the main burden while the winners of globalisation will contribute a minimal share – within and between countries.³⁹ For example, it is estimated that the 10 per cent poorest people in Brazil dedicate a 27 per cent of their income to VAT, against only 7 per cent for the 10 per cent richest.

2.2.6 The apparent growing autonomy of developing countries

Autonomy in policy decision-making for developing countries will probably not stem from the aid effectiveness agenda in spite of its repeated call for national ownership over development strategies. The Rome, Paris and Accra conferences have not evidenced a genuine willingness by donors to give up dictating economic policies in recipient countries. Henceforth, given the overall negative balance of externally driven tax policies, the weakening of international financial and trade institutions we are witnessing today could be interpreted as a positive shift for developing countries. In fact, the picture is slightly more complex.

With the dead-lock in the so-called ‘*Doha Development Round*’, the World Trade Organisation is going through a serious crisis. Yet, the weakening of this imperfect multilateral forum does not necessarily benefit poor countries. Power relations tend to be far more brutal in bilateral negotiations when compared to multilateral discussions. With the Doha Development Round at a stand-still, Northern countries have pursued bilateral trade agreements, most of which have proved detrimental to Southern countries, especially the weakest. The Economic Partnership Agreements (EPAs) that the European Union has been trying to impose on African countries, in particular, would seriously cut down tax resources revenues generated from trade. Togo, for instance, would face an approximate 30 per cent decrease in its tax revenue as a result of EPAs. It is estimated that African countries would

³⁷ JOC Nicaragua, December 2004.

³⁸ *Taxation and state-building with a (more) human face*, DIIS Policy Brief, October 2008.

³⁹ Smith, T. (2000) *Women and tax in South Africa*, Parliamentary Committee on the Quality of Life and Status of Women, CASE and Idasa.

need a doubling of European development assistance to compensate these losses, which is not only highly unlikely to happen but would also worsen the dependency of African States on foreign donors.

International Financial institutions (IFIs) also face a period of deep trouble (See Box 2 below). Nonetheless, they remain an inescapable interlocutor for many poor countries, especially in Africa.

Box 2: International Financial Institutions in crisis

The World Bank and the IMF were created in Bretton Woods in 1944 and were, so to say, never reformed since. This in itself has provided for a serious legitimacy deficit for these institutions.

They also face a crisis of mandate. After the management of the debt crisis by the IMF, the Asian crisis in 1997-98 and the Argentinean crisis in 2001, many Asian or Latin American countries do not want to require the support of the Fund ever again. The IMF was also incapable of preventing the sub-prime crisis in the US, the worldwide instability of financial architecture and its global effects. A growing international consensus is thereby calling for a complete overhaul of the IMF.

As for the World Bank, the failure of its policy recommendations was viewed to be so onerous that South American countries decided to create their own Bank of the South. In Africa, many countries now look towards China for new lending. Some Northern donors, such as Norway, the UK, the Netherlands and the Italian parliament, have also started questioning the conditionalities imposed by the Bank.

For the Bretton Woods institutions, the crisis has also become financial. The IMF lost almost all its clients and was forced to downsize in 2007. However, its activity has been recently growing again in the context of the global financial crisis. The Bank seems to be less under threat, but Norway by cutting 25 per cent of its planned increased financial contribution to the World Bank in 2007, showed that donors could reduce their contribution to the Bank unless it changed its policies.

Nevertheless, the IMF and the World Bank maintain their central position within the donor community. Most official creditors within OECD rely on the debt sustainability analysis of the Fund to inform their lending policies. The ongoing discussions within the G8 and the G20 on the idea of a responsible (or sustainable) lending charter will most likely result in giving even more weight to these analyses. Similarly, the ongoing process on aid effectiveness, since Rome in 2003, Paris in 2005 and ultimately Accra in September 2008, is likely to reinforce the central role of the World Bank and the IMF in the global aid architecture. There is indeed a risk that the coordination and alignment of donors, which have become the key words in the debate, will reinforce IFI positions rather than recipient countries' national development strategies. The already mentioned CPIA of the World Bank, which includes considerations of tax policy assessment, is likely to play an especially central role in this process. (*See for instance Roberto Bissio Application of the criteria for periodic evaluation of global development partnerships- as defined in Millennium Development Goal 8- from the right to development perspective: the Paris Declaration on Aid Effectiveness, Report of the Working Group on the Right to Development to the Eighth Session of the Human Rights Council December 2007.*) In the debate on renewing global financial architecture, the IMF might get a central role and increasing power whereas a substantive internal reform on voice and participation of developing countries and enhanced accountability is still missing.

In fact, the overall weakening of international economic institutions has had a differentiated impact on developing countries. Some have found other sources of external finance than Western donors. China, Brazil and India in particular offer an alternative to many resource-rich African countries. This waning dependency on the IFIs may be for the good in many cases since it creates more policy space, but it may also be for the bad where governments are held by authoritarian and deeply corrupt regimes. Besides, dependency, be it on China, would still remain. Other countries have accumulated monetary reserves or created new regional institutions, like in Asia and Latin America, not to depend any more on the World Bank and the IMF. Some countries, however, still remain highly dependent on the IFIs, including the majority of non resource-rich HIPC. The IFIs' influence may be waning globally, but its influence is as strong as ever on a small group of countries.

2.2.7 Conclusion

Externally-driven tax policies have had two major negative effects. Content wise, they have often been regressive, for the profit of the wealthy rather than with a concern for redistribution. Process-wise, they have prevented the elaboration of tax policies from playing a central role in fostering state accountability towards its citizens. The multiplication of tax exemptions, be they towards TNCs or donors, plays a deterring role in that context. CIDSE believes that state-building is central to development and that the key role of fair, transparent and efficient taxation in state-building should be recognised as such.

The weakening of multilateral economic institutions opens a situation of much uncertainty. It probably allows for more autonomy in some cases, but the weakest countries are most likely to lose out in unfair bilateral deals. Furthermore, it is very doubtful that such a weak global governance could provide a bold response to the regressive trends at stake in domestic tax systems worldwide. Public authorities in both South and North may well have common interests in a much stronger global action against tax erosion.

2.3 Maximizing profit versus raising CSR agenda

2.3.1 Mispricing

Beyond benefiting from the tax privileges because of intergovernmental tax competition, TNCs have taken advantage of the considerable trade in between their multiple companies (approximately 60 per cent of world trade⁴⁰) to develop complex mispricing strategies to avoid paying taxes (i.e. transfer mispricing). In principle, OECD guidelines state that goods traded between two subsidiaries of the same parent group must be at market prices - this is the “*arm’s length principle*”. If they are not sold at market prices, then it is considered to be transfer mispricing which is illegal. Because most transnational corporations come from OECD countries, they should abide by these laws, including for their operations in Low Income Countries (LICs). However, for tax authorities to verify that goods are traded at market prices between subsidiaries, they need to know the market price. This may be difficult to assess for intangibles (intellectual property, brands, logos, marketing, insurance, advertising, finance expertise, etc.), parts of an unfinished product and when trade in a particular sector is highly concentrated in a few companies. Moreover, LICs usually have limited domestic markets with no other company trading these goods, so they cannot find a comparable trade and henceforth have no idea what the market price is.

As a result, a whole accountancy industry has grown up around determining transfer prices and justifying them to tax authorities. TNCs use these complex mispricing strategies in order to shift their profits from high-tax to low-tax countries or territories. Annual reporting and accounting standards of TNCs provide no precise country-per-country information on where the company is active, nor on its respective turnovers, profits and taxes paid per fiscal year. These falsified pricing structures and distorted/manipulated capital structures coupled with non-transparency are major channels to avoid taxes. Despite scarce information available, an investigation by *The Guardian* found that major banana-trading TNCs had elaborated a whole such system in order to locate most of their profits in tax havens such as Bermuda, the Cayman Islands, Jersey and the British Virgin Islands⁴¹. Little is left to tax administrations in consuming countries like the US and Europe as well as in producing countries such as those in Central America. In Guatemala, the Centro Internacional de Investigacion sobre Derechos Humanos – a CIDSE partner organisation- revealed, in 2006, that TNCs such as Kellogg’s, Colgate-Palmolive and the mining company, Montana, abused the tax exemption laws. The cost for Guatemala was deemed at least a yearly \$400 million, i.e. 10 per cent of the budget⁴². The global

⁴⁰ OECD figure quoted in Murphy, Richard (2008), *Country-by-Country Reporting*, Tax Justice Briefing, March 2008.

⁴¹ Griffiths, Ian, and Laurence, Felicity (2007), *Bananas to UK via the Channel Islands? It pays for tax reasons*, *The Guardian*, 6 November 2007 - <http://www.guardian.co.uk/business/2007/nov/06/12>.

⁴² *Guatemalans Denounce Tax Evasion*, Prensa Latina, press release 19 June 2006.

annual loss of mispricing for developing countries was estimated at \$50 billion in 2000 – almost the total amount of global ODA at that time.⁴³

In May 2008, Christian Aid published a report entitled “Death and Taxes: the true toll of tax dodging” in which the cost for developing countries is estimated to reach \$160 billion a year. According to the report: “*Illegal, trade-related tax evasion alone will be responsible for some 5.6 million deaths of young children in the developing world between 2000 and 2015. That’s almost 1,000 a day. Half are already dead.*”

2.3.2 Revenue from natural resources

The issue of how much profit is left to producing countries is all the more acute in the sector of extractive industries. Recent years have seen a boom in commodity prices, although with huge fluctuations. The consultancy firm, Global Insight, revealed that Nigeria’s sovereign wealth rose 291 per cent in 2007 and Angola’s increased 84 per cent in the same year.⁴⁴ This has been further fuelled by the increasingly significant role played by so-called emerging countries such as China and India as well as by the speculation undertaken by hedge funds. Demand and competition for access to natural resources has steadily increased. Since many developing countries dispose of natural resources, growing demand would potentially strengthen their domestic income basis and consequently their social expenditures. Yet this is hardly the case. National and international circumstances prevent the country’s population, and especially the most affected local communities from benefiting from the socially and ecologically sustainable use of the countries’ resources.

The commodity price boom has attracted predatory behaviour much to the detriment of the host countries. This is evident in the way contracts for the extraction of natural resources are negotiated, usually with the host country receiving just a fraction of the promised revenue⁴⁵ and often at the expense of communities who are displaced to make way for the extractive activity.⁴⁶

- Extortion and bribery are easy ways to accumulate private wealth for government officials in developing countries with considerable natural wealth. The US Senate reported in 1999 that Omar Bongo, the President of Gabon since 1967, systematically shifted 8.5 per cent of public funds to his private account at the Citibank in New York⁴⁷. Responsible and transparent administration suffers as a result. Contracts for accessing and exploiting extractive resources are signed that profit local “elites” and their counterparts in trans-national companies while environmental concerns and the interest of the population are set aside.⁴⁸
- In some cases, national governments with the best intentions to serve the common good lack the capacity and bargaining power to negotiate fair deals with foreign companies and to monitor their compliance.⁴⁹ Some governments do not have sufficient control of some parts of their national territory allowing local rulers (and often war-lords) to illegally sell off precious resources to the detriment of communities living in these regions and their future generations. In many countries, notably in Democratic Republic of Congo (DRC), armed local conflicts and civil wars are fuelled by this illegal trade transforming development potentials into a dire curse.⁵⁰

⁴³ Oxfam (2000) *Tax havens: Releasing the hidden billions for poverty eradication*, Oxfam Briefing Papers, Oxford.

⁴⁴ Global Insight (2008), *Sovereign Wealth Fund Tracker*, London.

⁴⁵ Christian Aid (2007), *A Rich Seam: who benefits from rising commodity prices*, London.

⁴⁶ CIDSE (2008), *Recommendations to reduce the risk of human rights violations and improve access to justice. Submission to UN Special Representative on Business and Human Rights*, Brussels.

⁴⁷ Cited in CCFD (2007), *Biens mal acquis... profitent trop souvent. La fortune des dictateurs et les complaisances occidentales*, Working Document, 2007 - http://www.ccfid.asso.fr/e_upload/pdf/biens-mal-acquis.pdf.

⁴⁸ See for instance, Global Witness (2006), *Digging in Corruption, Fraud, abuse and exploitation in Katanga’s copper and cobalt mines*, Washington DC.

⁴⁹ SCIAF, ACTSA Christian Aid (2007), *Undermining Development? Copper Mining in Zambia*.

⁵⁰ Global Witness (2006), *The Sinews of War: Eliminating the Trade in Conflict Resources*.

- At the same time the lowering of tariffs and taxes undertaken by governments of developing countries under pressure by multilateral institutions, for the sake of free trade and a conducive ‘*business climate*’, also erodes their income base regarding extractive industry.⁵¹
- On the other hand governments do not receive sufficient international support for an effective management and monitoring of the extraction of their resource wealth by foreign (mostly big TNCs) companies. Albeit a positive step forward, the Extractive Industries’ Transparency Initiative (EITI) which was first launched in 2002, remains a voluntary initiative and it does not require a sufficiently detailed disclosure of data by governments and companies. Bank secrecy, tax havens, international accounting standards all work in favour of non-transparent profits of TNCs and corrupt local ‘*elites*’. It is obvious that governments of industrial (and to a growing extent: emerging) countries see a clear priority for securing cheap and uninterrupted access to raw materials and energy for their economies against more fairness and transparency in the use of natural resources in developing countries.⁵²
- Since the 1980s, international public and private lenders have increasingly made use of mortgaged loans to developing countries in order to secure long-term access to natural resources. This has proven to be an extraordinarily powerful means to exploit resource-rich developing countries. This could be partially attributed to the short-term vision of many political leaders in power. Yet in many cases developing countries’ governments need these loans as they face immediate budgetary shortfalls, both to cover public expenditure and to repay or service massive debts accumulated since the early 1980s. In various countries, oil companies have indeed formed an alliance with lenders, be they private banks or sovereign lenders, to guarantee a loan against the access to oil for 5 to 15 years at very low-price. This is the case of French company Elf (now Total), in liaison with French banks such as BNP Paribas, Société générale and Crédit agricole, in Congo-Brazzaville. For instance in 1998, Crédit agricole lent \$60 million to the autocrat Denis Sassou Nguesso against the provision of oil at the price of \$7 per barrel. Congo-Brazzaville, with 70 per cent of its population living under the poverty line, now has a debt representing about 3 times its GDP, despite being the 4th oil producer in Sub-Saharan Africa⁵³.

This situation is reflected in the very low tax rates and royalties and in special arrangements like tax holidays and tax exemptions for foreign companies which are active in the extractive sectors of developing countries’ economies. Even nominal rates are often not paid due to corruption and non-transparent practices such as mispricing and transfer pricing via tax havens.

This is a multi-faceted problem, and it is hard to measure, though several estimates available suggest that the problem is very large. For example, in July 2008 the Washington-based Global Financial Integrity Program (GFI) published a report⁵⁴ estimating that the Democratic Republic of Congo (DRC) lost approximately \$15.5 billion due to capital flight from 1980 to 2006. According to the accompanying press release: “*‘pervasive corruption’ and trade mispricing in goods and services led to a per annum loss of nearly \$600 million dollars from the DRC economy. Notes the report’s author, lead economist Dev Kar: “With that money, the DRC could have paid off its entire external debt, which is \$11.2 billion.”* The report itself revealed: “*increasing the tax take from mining - including by fighting corruption - is paramount for both mobilizing revenue. In the 1980s, the mining sector contributed 25 per cent of total tax receipts, 75 per cent of total exports and 25 per cent of GDP. In 2005, the Congolese government reported that \$27 million was collected as tax receipts from the mining sector (2.4 per cent of total fiscal receipts).*”

⁵¹ FIDH (2007), *Gold Mining and Human Rights in Mali* - http://www.fidh.org/IMG/pdf/Mali_mines_final-en.pdf.

⁵² Global Witness (2002), *All the Presidents’ Men: The Devastating story of oil and banking in Angola’s privatised war*.

⁵³ Eurodad et al (2007), *Skeletons in the Cupboard. Illegitimate Debt Claims of the G7*, Joint NGO Report, February 2007.

⁵⁴ Kar, Dev, Mammadov, Ramil, Goodermote, Rachel and Upadhyay, Janak (2008) *Capital Flight from the Democratic Republic of Congo*, Global Financial Integrity at the Center for International Policy, July 2008 - <http://www.gfip.org/storage/gfip/documents/capital%20flight%20from%20drc.pdf>.

Another report, in July 2008,⁵⁵ from the University of Massachusetts Amherst estimated that in Sub-Saharan Africa, “*real capital flight over the 35-year period amounted to about \$420 billion (in 2004 dollars) for the 40 countries as a whole. Including imputed interest earnings, the accumulated stock of capital flight was about \$607 billion as of end-2004. (...) The subcontinent’s private external assets belong to a narrow, relatively wealthy stratum of its population, while public external debts are borne by the people through their governments.*” Much of this capital flight originated in African countries rich in natural resources, such as Nigeria, Angola, Cameroon and the 2 Congos⁵⁶.

In the rare event that a government attempts to renegotiate contracts and raise taxes and royalties, it usually faces strong resistance. This was the case in Bolivia when the newly elected president, Evo Morales, announced a renegotiation of contracts for the exploitation of natural gas resources, taxed at a very low rate until then.

Nevertheless, some governments have adopted innovative ways to manage natural resources which differ completely from common corporate rationale. This is the case in Ecuador where the current government decided not to exploit a part of its oil resources in order to preserve them for future generations. The East Timorese government has taken similar steps.

2.3.3 Accountability of the private sector

In this context of growing corporate power and enrichment, the idea has gained momentum that with their considerable influence, trans-national corporations have to take responsibility for the social and environmental consequences of their practices. This trend could be an opportunity for tax compliance to be considered a core corporate responsibility and for tax evasion schemes to be fiercely combated:⁵⁷

- Over the last decades voluntary corporate and industry codes and corporate social responsibility (CSR) initiatives have proliferated. Such voluntary codes of conduct usually tend to be applied by industry sectors that are highly visible and/or very sensitive to consumer opinion and behaviour.
- The ‘*Norms on the Responsibilities of Trans-national Companies and Other Business Enterprises with regard to Human Rights*’ which were unanimously adopted by the UN Sub-Commission on the Promotion and Protection of Human Rights, remain the most comprehensive and detailed document to guide enterprises in order to ensure that their business activities do not contribute to human rights violation. These Norms were not adopted by the UN Human Rights Commission who chose to mandate an expert, Harvard Professor Dr. John Ruggie, to submit a report on the issue for its further consideration.⁵⁸ Yet, discussions on corporate accountability have so far rarely dwelled on the responsibilities of enterprises. The causes of this are both political and technical. Politically, taxes are wrongly considered a cost rather than a return on investments made by the community that contribute to the productivity of an enterprise and the well-being of the individual. Technically, it remains difficult to uncover transfer pricing and the many other mispricing practices as a result of the very complex constructions that have come to be built around them.
- The OECD guidelines for Multinational Enterprises, besides policies on disclosure, labour and consumer rights and environmental considerations, contain a paragraph on tax payments. However, they are limited to companies based in OECD countries including their investments in third countries. Even more fundamentally, they are not legally binding and have a weak monitoring and settlement mechanism⁵⁹.
- So-called ethical or responsible investment has rapidly developed in recent years. Every Western bank now offers at least an ethical investment financial product to its customers. Ethical

⁵⁵ http://www.peri.umass.edu/fileadmin/pdf/working_papers/working_papers_151-200/WP166.pdf.

⁵⁶ See table, p. 41 of the above-mentioned report.

⁵⁷ CIDSE (2008), *Recommendations to reduce the risk of human rights violations and improve access to justice. Submission to UN Special Representative on Business and Human Rights*, Brussels.

⁵⁸ Human Rights Council (2008), *Protect, Respect and Remedy: a Framework for Business and Human Rights. Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises John Ruggie.*

⁵⁹ http://www.oecd.org/document/28/0,3343,en_2649_34889_2397532_1_1_1_1,00.html.

considerations vary from scheme to scheme, but they usually take the form of the exclusion of certain sectors (e.g. investors unwilling to have their money invested in the arms industry or in the tobacco or alcohol industry) and/or the selection of best rated quoted companies according to a set of criteria assessing, in particular, social and environmental performance. Some rating agencies have developed specialised rating on social and environmental matters. The integration of tax justice criteria as part of these assessments has been the subject of recent discussions at the 2008 Forum for European Responsible Investment⁶⁰. Promising proposals were made to enable responsible investors to avoid investing in companies refusing to provide them with detailed explanations and data of their activities offshore.

- With respect to countries rich in natural resources, several initiatives have emerged as a result of civil society actions, including the Forest Stewardship Council label for forest products and the Kimberly process certification scheme for diamonds. The international Publish What You Pay (PWYP) campaign, among other things, is urging regulators and accounting standards bodies in the developed worlds to require mineral extraction companies to publish disaggregated data on payments between companies and mineral-rich governments, as a way to boost transparency and give citizens of mineral-rich countries the tools to enable them to ‘*call their rulers to account.*’ Since its launch in 2002 PWYP has successfully made the case for greater disclosure of extractive company payments. In November 2007 the EU Parliament endorsed the call for using international accounting standards, which are set by the International Accounting Standards Board, to require country-by-country reporting for the extractive industries and it required the European Commission to support this proposal. Currently, regulations and standards only require companies to publish this in regional or global form, and it is often impossible to unpick published data to find out what is happening at a country level. This mandatory approach would be a revolutionary step forward in transparency. However, to date oil companies and western governments have favoured the slower, multi-stakeholder EITI approach whose main drawback as mentioned above is its voluntary nature.
- Anti-money laundering legislations may also become strong instruments to hold financial intermediaries accountable to both the judiciary and tax administrations. The European 3rd anti-Money Laundering Directive, which was adopted in 2005 as a result of the recommendations of the Financial Action Task Force (FATF), indeed widened the number of professions and the scope of responsibility of financial intermediaries to help the judiciary track dirty money. Practically, it is not only the banks but also the casinos, the art galleries, the housing agencies, the accountants and the lawyers who are obliged to tell the anti money laundering unit when they suspect dirty money. This obligation now covers a wide range of offences and crimes, including tax evasion in many European countries. All member states were supposed to make the necessary legal arrangements to implement the 3rd Directive by end 2007.

2.3.4 Conclusion

Current tax systems based on the nation state face increasing constraints due to the mobility of capital and activities of TNCs. This leads to international tax competition, a race to the bottom on tax, regulation and secrecy, and the erosion of national tax bases with all their social and economic implications. One of the biggest consequences is that taxes are being shifted away from capital and onto labour and consumption, with a consequent highly negative impact on the progressivity of national tax systems, and hence strongly negative impacts on inequality and poverty.⁶¹ In parallel, various corporate actors, having taken enormous advantage from globalisation, have become much more powerful than many states. Yet, they are not held accountable in any democratic fashion – but only to their shareholders. CIDSE joins the call for trans-national corporations to be accountable for their social and environmental responsibilities, which includes at the forefront the due payment of taxes. The response to this can only be partially at the national level or on a voluntary basis. CIDSE believes that these problems need joint efforts in international instances.

⁶⁰ See: http://www.frenchsif.org/fr/documents/faire2008/programme_uk.pdf.

⁶¹ For more details, see: http://www.taxjustice.net/cms/front_content.php?idcat=102.

2.4 Tax havens, tax evasion and corruption versus transparency and regulation

Besides the challenges of tax competition as outlined above, other trends have gained increasing attention. With the growing importance and openness of financial markets and cross-border investments and use of technical facilities, Offshore Financial Centres (OFCs) or tax havens have become the central obstacle to any form of tax justice.

2.4.1 *The central obstacle to tax justice*

Tax havens, that are also called secrecy jurisdictions⁶², were created to escape the laws elaborated elsewhere, be they financial regulation, fiscal or criminal law. They challenge each of the key functions of taxation (the 5 'Rs'):

1. They weaken revenue collection systems by the leakages they create through tax evasion and avoidance, as well as by the tax rate race to the bottom they exacerbate. They thereby undermine the moral support to pay taxes in other countries.
2. Tax havens counteract policies to bring about wealth redistribution. Wealth remains concentrated in the hands of the wealthiest. Tax competition is all the more fierce on mobile sources of taxation, especially the wealth of rich individuals and the profit of trans-national corporations and banks. Meanwhile, the poor are made to pay a higher share of tax revenues, especially through indirect taxes.
3. Secrecy jurisdictions severely weaken the impact of other countries' regulatory frameworks, as evidenced by the role of hedge funds - many of which are based in OFCs - in the current financial turmoil.
4. Tax havens do not have very much of an impact on "re-pricing" policies. However, there are a few that do. Andorra, for instance, by favouring cross-border trade of duty-free goods such as alcohol and tobacco. They also represent a large obstacle to the implementation of global taxes, with a re-pricing objective e.g. on financial transactions.
5. Beyond their role in weakening tax systems, which have proved to be a key channel of political representation, secrecy jurisdictions are a direct threat to democracy. They protect the corrupt, they function as depositories of finance for such as illicit activities as supporting corrupt regimes and organised criminal networks (see box 3).

2.4.2 *Tax havens at the heart of the global economy*

As defined by the IMF, offshore financial⁶³ centres (OFCs) are characterised by relatively large numbers of financial institutions engaged primarily in business with non-residents. Their financial systems - oversized compared to domestic needs - are to a large proportion dealing with external assets and liabilities. Little or no tax is levied on financial activities. There is moderate or light financial regulation and high anonymity or secrecy in bank matters with little data transparency. These factors serve to make such financial centres '*Tax havens*'.

Tax havens are also financial havens since they have very loose financial regulation: for example, they are not bound by the banking standards elaborated by the Basel Committee regarding solvability ratios. This is why they shelter up to two thirds of total hedge funds, which take any risk to make profit out of speculation. They are also judicial havens, since they almost systematically refuse to cooperate with foreign tax and judicial administrations.

⁶² For a discussion about the concepts at stake, see: <http://www.taxresearch.org.uk/Blog/2008/08/27/finding-the-secrecy-world/>.

⁶³ IMF- <http://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf>.

Tax evaders use exactly the same mechanisms and loopholes in the global financial architecture that criminal networks and corrupt operators do. These include the use of trusts, dummy corporations, bank secrecy, tax havens, offshore companies, international business corporations (IBCs), foundations, correspondent banks, nominee directors, dummy wire transfers, and many other subterfuges, all taking place in an absence of financial transparency. Legal institutions granted special status and privilege by society have been subverted to purposes for which they were never intended.

Secrecy jurisdictions have taken a central place in the world economy. The IMF used to identify 25 such financial centres in the 1970s, against more than 60 at present. The City in London and the State of Delaware in the USA are considered by many (like, respectively, the IMF and Brazil) as secrecy jurisdictions. 4000 banks are located in tax havens. An approximate half of daily financial transactions take place through tax havens, which also carry a huge weight in global investment. The Cayman Islands, for instance, are the 5th biggest financial centre worldwide and the first foreign investor in China.

Box 3: Tax havens provide a shelter for stolen assets

The practices of OFCs tend to attract illicit outflow of finance and support corrupt activities. Assets looted by dictators are often held by bank accounts in countries which guarantee banking secrecy and anonymity. E.g. in 2005 Swiss accounts held assets worth \$600 million of the former Filipino dictator, Ferdinand Marcos, \$700 million of the former Nigerian dictator, Sani Abacha as well as further assets of the former dictator of Zaire, Mobutu Sese Seko, Haitian dictator, Jean-Claude Duvalier and Liberian dictator, Charles Taylor. Since 2006 parts of these assets have been restituted through transparent negotiating processes if legal conditions were met.

Like Switzerland some other countries have started to take action and cooperate with the international community. Nevertheless, the problem still prevails to a large extent, both due to a lack of political will in many countries where stolen wealth is located and because of the opacity of offshore finance.

Table : Dictators and their loot

Country / DICTATOR / period	Estimated looted assets (\$)	Amount repatriated from abroad (\$)
Philippines / MARCOS / 1965-86	5 to 10 billion (bn)	658 millions (mn) (Switzerland-2003)
Mali / TRAORE / 1968-91	1 to 2 bn	2.4 mn (Switzerland / 1997)
Nigeria / ABACHA / 1993-98	2 to 6 bn	160 mn (Jersey / 2006) 594 mn (Switzerland / 2002-05)
Angola / DOS SANTOS / 1975-	several bn	21 mn (Switzerland / 2005)
Peru / FUJIMORI / 1980-2000	0.6 to 1.5 bn	100.7 mn (Switzerland / 2000-04) 20 mn (USA / 2006)
Haiti / DUVALIER / 1971-86	0.5 to 2 bn	
RDC - Zaire / MOBUTU / 1965-1997	5 to 6 bn	
Kazakhstan / NAZARBAEV / 1991-	1 bn	
Korea / MOI / 1978-2002	3 bn	
Indonesia / SUHARTO / 1967-98	15 to 35 bn	
Iran / KHAMENEI / 1979-	35 bn	

Source : OECD, Base and others, *probing the sources: la fortune des dictateurs et les complications occidentales*, April 2007.

2.4.3 Regulation and transparency

What brings hope to the seemingly endless combat against secrecy jurisdictions is the striking convergence of various interests to end secrecy. No matter what the single factor is that would bring more financial transparency and regulation, it would bring much wider benefits. Progress is likely to come from any of the following three streams of opportunity:

1. Financial Crisis

The ongoing financial crisis, which many describe as the deeper one since 1929, is considered in many respects to be due to a lack of regulation. Given that tax havens deliberately undermine the impact of other jurisdictions' legislations, there is little hope that any new regulation would be of any use unless it also applies to tax havens. Even if tax havens are not at the very root of the subprime crisis, they have created the conditions contributing to the magnitude, the continuation and the deepening of the crisis. First, while much of the problem occurred in what most people would consider to be "onshore", this is a false perception. For example, many of the risks that were "parked" inside the United States were in fact located in the state of Delaware. This state, as rightly identified in a Brazilian law in June 2008⁶⁴, is in effect a tax haven inside the United States: the result of years of regulatory competition between states inside the United States which has resulted in Delaware becoming the registry of choice for many large companies on account of its extremely lax regulation.⁶⁵ Besides, the opacity of offshore finance has fuelled a distrust towards hedge funds, most of which are located in tax havens and have had to sell rapidly their shares of companies in stock exchange - with an immediate decreasing effect- in order to try to honour the many demands for early repayment they have been facing. More fundamentally, tax havens have been central for the perpetuation of financial turmoil for deeper reasons: by ensuring secrecy and favouring complex financial arrangements, they allow the concealment of excessive risks taken by banks and companies and bring much uncertainty to the financial markets. The Chamber of Commons in the UK, for instance, spent a whole night wondering whether Northern Rock's shadow company in Jersey, namely Granite, was to be nationalised as well, given the blur status of this affiliate.⁶⁶ This uncertainty generates much distrust, which in turn hits the inter-banking market.

Various countries have stressed the need to tackle the issue of tax havens while dealing with the crisis. French Prime Minister, François Fillon, addressing the European Parliament on 14 October 2008 during the French Presidency of the European Union, called for the suppression ("disparition") of tax havens. Various heads of state, including from Germany and France, as well as the IMF Managing Director have also asked for this issue to be on the agenda of the Summits to reform the current global financial architecture.

2. Raising discontent over tax evasion

Initiatives to strengthen regulation and transparency against tax evasion, followed by efforts by vested interests in the financial community and elsewhere to neutralise them, have a long history (see box 4).

Box 4: History of international efforts to stem capital flight

Towards the end of the Second World War, John Maynard Keynes of Britain and Harry Dexter White of the United States, architects of the Bretton Woods system, designed a proposal to stem capital flight out of post-war Europe – to prevent the continent from being destabilised by it. They proposed international financial transparency as their key tool. The governments of countries receiving flight capital (principally the U.S.) would share information automatically with those European (and other) governments suffering from capital flight, so that the sending countries could 'see' the wealth their citizens had sent abroad. This would allow weak countries to tax their citizens' foreign income appropriately, and remove one of the great incentives for capital flight. The U.S. financial community lobbied hard against transparency and Keynes' and White's proposals were watered down in the final IMF Articles of Agreement. International co-operation between countries was now no longer 'required' but merely 'permitted.' This remains one of the great weaknesses of international finance today. The OECD, in the late 1990s, tried to build a coalition of developed countries to act together to require transparency in international banking, and to fight against 'harmful tax competition'. After some initial successes including the powerful exercise of naming and shaming 40 non-cooperative tax havens, these efforts, however, foundered in 2001 partly because the United States defected after George W. Bush's election in 2000.

⁶⁴ <http://www.meujournal.com.br/para/Jornal/Materias/integra.aspx?id=51434>.

⁶⁵ For an illustration of Delaware's lax regulation, see: <http://www.taxresearch.org.uk/Blog/2008/04/18/the-delaware-llc-its-got-to-go/>.

⁶⁶ This example was given by John Christensen and Richard Murphy in *Tax havens and the financial crisis*, an article integrally published in October 2008 on: www.taxjustice.net.

However, from around 2007 onwards, momentum started to move in the other direction, creating grounds for optimism that political will is now starting to emerge to tackle these issues. Some events have spurred this: the Liechtenstein tax evasion scandal in February 2008 helped to focus minds in Europe; an emerging scandal over the activities of the Swiss bank UBS in the United States in helping wealthy clients to break U.S. laws by using Swiss bank secrecy as well as some investigations into tax abuses by the US Permanent Subcommittee on Investigations have helped to provoke outrage in America over tax abuse.⁶⁷

More generally, there has been increasing concern in many countries about the scale of state income losses⁶⁸ and wealth inequalities within and between countries. It has not gone unnoticed that taxation is a fundamentally important issue in this respect. New research and advocacy is also starting to emerge - and this report is an example of it - on recognising the importance that taxation plays in fostering good governance and building effective and accountable institutions in developing countries, bolstering the case for checking tax abuses. The '*Stop Tax Haven Abuse Act*' co-sponsored by Barack Obama when he was Senator of the State of Illinois is symptomatic of the beginnings of this shift. In October 2008, in Paris, 17 OECD countries adopted an even bolder stance, expressing their deep concern about very slow progress made regarding transparency and exchange of tax information. They urged non-complying countries to make rapid progress and agreed to meet again before mid-2009. In recent years, some Southern countries such as Brazil and South Africa have equally been very vocal against tax evasion, which gives some hope for the emergence of global action against tax havens. What is more, the emergence of civil society groups and think-tanks such as Global Financial Integrity and the Tax Justice Network, among others, show that global civil society is, at long last, starting to engage in these issues.

3. Money laundering and corruption

Money laundering is the fact of dissimulating or transforming into clean money funds of illicit origin, be they from drugs trade, corruption, counterfeiting, arms or human trafficking. By providing secrecy and no judicial cooperation, tax havens are obviously at the heart of international money laundering. In 1989 the G8 created the Financial Action Task Force on Money Laundering (FATF)⁶⁹, which was supposed to spearhead initiatives to strengthen internal regulations relating to money laundering and to improve exchange of information with OFCs.

The FATF set a relevant list of 40 anti-money laundering recommendations, including the removal of banking secrecy, the registering of trusts and the implementation of the '*Know Your Customer*' (KYC) norms. This list was lengthened by 9 other recommendations following the US push to better track dirty money under their anti-terrorist agenda. This little progress in secrecy jurisdictions irrespective, the FATF black-list of tax havens was emptied in 2006 with the FATF never having real sanctioning power. Like the action of the OECD, this initiative is said to have served to "*legitimise the illegitimate*"⁷⁰ in the words of their critics, who highlighted the fact that the FATF had effectively given Liechtenstein a clean bill of health, amid a large-scale tax evasion scandal involving wealthy Germans and many others using Liechtenstein's strong bank secrecy laws to evade taxes. It is worth noting however that FATF rules generated considerable changes in anti-money laundering legislations in many countries, especially in the European Union where the above-mentioned 3rd anti-Money Laundering Directive may be a powerful tool to combat illicit finance, including possibly tax evaded money.

⁶⁷ Permanent Subcommittee on Investigations of the Committee of Homeland Security and Governmental Affairs (2008), *Tax Havens Banks and US Tax Compliance*, United States Senate, Washington DC.

⁶⁸ Between \$100 billion and \$150 billion for the US federal budget, according to the US Senate; between €40 and 50 billion for France according to estimates by the European Commission and the SNUI - Tax administration Trade Union.

⁶⁹ The Financial Action Task Force on Money Laundering (FATF), also known by the French name *Groupe d'action financière sur le blanchiment de capitaux* (GAFI), is an inter-governmental body founded in 1989 by the G7. The purpose of the FATF is to develop policies to combat money laundering and terrorist financing.

⁷⁰ See Christensen, John and Spencer, David (2008) *Stop this timidity in ending tax haven abuse*, Financial Times, 4 March 2008 - <http://www.ft.com/cms/s/0/63cdb642-ea03-11dc-b3c9-0000779fd2ac.html>.

In fact, international action against tax and judicial havens may result from the growing anti-corruption agenda. Corruption is indeed now recognised as one of the most important issues, in the field of international development policy. Such organisations as Transparency International have helped make it a core issue in international norm-setting. The OECD adopted its Convention against corruption in 1997 and its implementation is closely monitored by a powerful peer pressure mechanism. The UN Convention against Corruption (UNCAC), which was adopted in Merida in 2003, marked significant progress by making the return of stolen assets a key principle of international law, with a special focus on Politically Exposed Persons (PEPs). In the spirit of helping this principle become reality, the UNODC and the World Bank launched a common Stolen Assets Recovery (StAR) initiative in September 2007.

This rising anti-corruption agenda may lead to a bolder international action against havens for stolen assets. The StAR initiative found that “*the main techniques used to launder the proceeds of corruption include wire transfers, the use of shell corporations in bank secrecy jurisdictions, and direct deposits in the form of cash or bearer instruments*”⁷¹. It therefore required every developed and developing country to comply with all FATF recommendations and asked OECD and G8 countries to “*put pressure on emerging market countries serving as havens for stolen assets to ratify and implement UNCAC*”. One could wonder why the finger was pointed at “emerging market countries” while most havens depend on OECD countries, but it remains a fact that the perception of corruption has been changing. The emphasis is no longer uniquely on developing countries where it has had the most severe impacts, but also on the financial schemes which help hide dirty money.

The Tax Justice Network (TJN), Global Financial Integrity and some others have pointed out how misleading it is to focus on the corruption problem *inside* nation states, while ignoring two things: the global aspect of the problem, on the one hand, and the full extent of the “*supply side*” of corruption, on the other.⁷² Henceforth they ask for the removal of Transparency International’s Corruption Perceptions Index (CPI), which ranks countries according to perceptions of how corrupt they are.

African countries feature heavily near bottom of Transparency International’s ‘Perceptions of Corruptions’ list and therefore compete to be ranked the “*most corrupt*.” Tax havens such as Switzerland, the UK, Singapore, Luxembourg, Austria and others, rank among the “*cleanest*” (and Transparency International’s complementary Bribe-Payers’ Index ranks Switzerland as the “*cleanest*”) even though these countries are destinations for illicit and corrupt financial flows that emerge from African (and other) countries. If the global picture was taken into account, the ranking would change dramatically.⁷³

The Tax Justice Network also suggests that the notion of the supply side of corruption should be dramatically expanded, so that it moves beyond the relatively narrow aspect of bribery, and considers the larger flows of illicit dirty money, including tax evasion - which, they argue, “*use exactly the same mechanisms and subterfuges as they shift across borders (...) all abetted by a supporting array of mainstream bankers, lawyers and accountants*”⁷⁴. Aside from the theoretical argument, there are practical considerations. One is the scale of what is involved. Expanding anti-corruption mechanisms, such as the StAR initiative, to the proceeds of tax evasion could prove to be quite powerful, all the more as the scale at stake is different. This would make sense since tax evasion is no more than another form of theft of public revenue. According to Raymond Baker (whose estimates are endorsed by the World Bank), only \$30-50 billion, or about three per cent of annual illicit cross-border flows, is

⁷¹ World Bank and UNODC (2007), *Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan*, Washington DC, September 2007.

⁷² See Christensen, John (2007), *Mirror, Mirror on the Wall, Who’s the Most Corrupt of All?*, Tax Justice Network, January 2007 - http://www.taxjustice.net/cms/front_content.php?idcatart=134.

⁷³ The Tax Justice Network is currently engaged in a project in partnership with Transparency International for the creation of an alternative index, to be called the Financial Transparency Index (FTI). For more details, see: http://www.taxjustice.net/cms/front_content.php?idcatart=217&lang=1&client=1#6.

⁷⁴ Baker, Raymond, Christensen, John & Shaxson, Nicholas (2008) *Catching up with corruption*, The American Interest, September / October 2008 - <http://www.the-american-interest.com/ai2/article-bd.cfm?Id=466&MIId=21>.

estimated to involve flows originating from bribery, whereas commercial mispricing, abusive transfer pricing and fake transactions – which allow tax evasion - account for over 60 per cent of the total.

Beyond civil society organisations, the thinking on corruption has also shifted among politicians, as evidenced by the very pointed report by the UK Parliament meaningfully entitled “*The other Side of the Coin: the UK and corruption in Africa*”: “*Poor enforcement of laundering regulations lead some experts to suggest there is as much as \$1 trillion of illicit cross border flows annually. Unfortunately the UK, including the City of London and Overseas Territories and Crown Dependencies, has been implicated in this practice*”⁷⁵.

2.4.4 Conclusion

In the context of the systemic financial crisis, alongside massive tax losses both in North and South and the raising awareness about the role of the offshore world in protecting the corrupt, the momentum for putting an end to the tax haven scandal has never been so high. CIDSE believes that current political leaders convey a historic responsibility just to do it.

III. GLOBAL GOVERNANCE CHALLENGES AND GLOBAL RESPONSES: INTERNATIONAL TAXES AND TAX GOVERNANCE

Beyond the concern for international peace and stability, which lies at the very foundation of the United Nations at the fall of the Second World War, it has become evident that various challenges are best tackled at the international level. It is also clear that there is no satisfactory global response to most global issues. This is the case, for instance, in the areas of finance, arms’ trade, food security, energy, health and epidemics, the environment, etc. Yet, there is scope for increasing multilateralism. The global dimension of the tax issue should be considered in this changing context, tax also being a possible instrument of global regulation.

3.1 Global governance at the crossroads

Instability in the international financial system and combating climate change are two global challenges regarding which there is growing consensus about the insufficiency of current global responses. This offers both opportunities for change and uncertainty.

3.1.1 Financial instability

The poor are especially vulnerable to trade shocks and financial crises. Asia faced a deep financial and economic crisis in the late 1990s due to overindebtedness in particular and above all to massive speculation on various Asian currencies. In the course of the crisis, the number of people below the poverty line in Indonesia doubled⁷⁶ and political instability increased. The fiscal cost due to the 1997 banking and currency crisis was most likely borne by the poor⁷⁷.

The current financial crisis clearly shows the risks of an internationally most integrated market without adequate global regulation. Tax havens have been at the centre of the deregulation process, although mainstream economic commentators have hardly noticed the role they have played. The role of tax havens has been to accelerate a process of international regulatory competition between jurisdictions involving a race to the bottom on regulation.

⁷⁵ A Report by the Africa All party Parliamentary Group, March 2006, p. 20.

⁷⁶ World Bank, *The Challenges of Social Policy and Governance*.

⁷⁷ Oxfam (2002), *Global finance hurts the poor*.

Tax havens, by promoting lax or non-existent regulation, in combination with very low or zero taxes and widespread secrecy, encouraged multinationals to split themselves widely between different jurisdictions, massively increasing the complexity of their operations and particularly – in the context of the current crisis which has resulted, at heart from an excess of risk-taking – the hiding of risks and moving them outside the scope of regulation.

This has resulted in what the Bank for International Settlements, and others, have called the “shadow banking system” which emerged almost unnoticed. Yet it allowed narrow sections especially in the international financial community to amass enormous wealth. In the process they have used the tax haven system to distance themselves from the financial risks associated with their acquisition of this wealth – and now that these risks are materialising, it is becoming apparent that the risks will, to a very substantial degree, be socialised – in other words their costs will be borne by taxpayers, not by the wealthy risk-takers.

While this crisis originated in the USA, developing countries and emerging economies suffer in multiple ways: besides direct financial contagion and spillovers to stock markets and indirect effects such as reduced export revenues, slowing growth and rising unemployment they come under pressure by high food and fluctuating commodity prices and devaluation of their currencies. Moreover, they face further financial constraints by reduced FDI, remittances, high costs of lending and possible aid cuts.

The global response to financial instability is scattered, it lacks legitimacy and efficiency. Many global institutions - including the Financial Stability Forum, the Basel Committee and the IMF - notwithstanding regional institutions and ad hoc groupings such as the G20, are meant to deal with financial stability. The US-originated crisis can be interpreted as their collective failure. Besides, as mentioned above about the IMF, all these institutions leave little voice and power to poorer countries, albeit being many times the victims of financial turmoil.

Although this dark picture leaves little space for hope, there has been significant change in the discourse about global finance.

Firstly, even before the subprime crisis, financial stability has increasingly been referred to as a “global public good”⁷⁸. The logical consequence of this is that international financial stability cannot be ensured by institutions that are managed on the basis of the ‘one dollar, one vote’ principle. This is closely linked to the call made by many, including Germany and the current IMF Managing Director, Dominique Strauss-Kahn, to introduce the double majority principle for decision-making at the IMF. Important decisions would require both a majority vote based on current quotas and a majority vote of member states.

The current financial crisis has also resulted in strong calls for the overhaul of global financial architecture. Although the process for such reform and the outcomes are uncertain, the crisis has proved that global regulation remains an empty concept when a major actor can ignore the rules. A major reason why the IMF has proved to be incapable of controlling imbalances in rich countries’ economies, while putting much emphasis on dictating tight economic policies in the developing world, is due to the veto power of the US in its Board of Directors.

Beyond the specific issue of US quotas at the IMF, there is a growing awareness among decision-makers of the need for strengthened multilateral institutions. It is quite telling that Robert Zoellick himself, who was appointed to head the World Bank by the Bush administration, called for a “*new*

⁷⁸ This is the case, for instance, of the EU General Affairs and External Relations Council Conclusions dated 11 November 2008, as drafted mid-October 2008, §6.

multilateralism" to replace outdated structures⁷⁹. UN Secretary General Ban Ki-Moon stressed the "UN's responsibility for leading an 'inclusive multilateralism' that would need to be reflected in any discussion of the reform of the international monetary and financial system"⁸⁰ when meeting economic experts and international finance institutions on the financial crisis in October 2008. A UN task force to review the global financial system has been set up on the initiative of the General Assembly President⁸¹.

In this context, there may be more room than ever for innovative mechanisms to regulate global finance, including taxes on financial transactions as proposed by Austrian academics (see section 3.2.3 below). This could also be the time indeed for a tax on currency transactions, as suggested by a recent editorial in UK newspaper *The Guardian*: "a levy on currency transactions could raise billions and act to calm markets in turmoil"⁸².

An equally plausible alternative to strengthened multilateral financial institutions may also be the development of strong regional financial institutional arrangements, including regional taxation systems. Many countries in Asia and Latin America, in particular, seem to prefer regional stability funds over which they have control rather than global institutions which they fear would remain in others' hands.

3.1.2 Climate change

Climate change is clearly a global challenge, as evidenced by new studies confirming that Africa will be most adversely affected by climate change – mainly caused by industrialized countries.

Economically-developed countries with their previously unchecked consumption of natural resources and the generation of huge amounts of pollution have accelerated natural weather cycles which in turn are devastating some of the poorest and most vulnerable people. Industrialised countries have contributed the most to the global stocks of carbon - they are responsible for 7 out of every 10 tonnes of carbon dioxide emitted since the start of the industrial era.⁸³ In so doing, polluting countries have benefited from the unregulated exploitation of the environment and now have a serious obligation - an 'ecological debt' to pay for the damage that has been done. The impact of their actions being global, their responsibility also needs to be addressed at a global level.

At the Earth Summit in Rio in 1992, the international community took its first step towards concerted action on climate change by producing the United Nations Framework Convention on Climate Change (UNFCCC). With the first commitment period of the Kyoto protocol ending in 2012, negotiations are underway for the next phase of global action on climate change.

Developing countries have insisted that the principles of equity, mutual accountability and common but differentiated responsibility in the UNFCCC must be the basis of all further global action on climate change, including finance to reduce or turn-around action that contributes to climate change. The demand for a global framework for action on climate change, set within the context of financing responsibilities of industrialised countries, is particularly significant in the face of mushrooming new funds created by bilateral donors or entrusted to the World Bank to purportedly fill in the gaps in the UNFCCC.

⁷⁹ Speech given on 6 October 2008 at the Peterson Institute for International Economics, in Washington DC. See: <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21927552~pagePK:34370~piPK:42770~theSitePK:4607,00.html>.

⁸⁰ Statement attributable to the Spokesperson for the Secretary-General on discussion on the international economic situation, New York, 24 October 2008 - <http://www.un.org/apps/sg/sgstats.asp?nid=3492>.

⁸¹ <http://www.un.org/ga/news/news.asp?NewsID=28643>.

⁸² Elliott, Larry (2008), *Tobin's nice little earner*, *The Guardian*, 15 October 2008.

⁸³ United Nations (2007-2008), Human Development Report 2007, *Fighting Climate Change*, Summary.

Within the discussion of financing mechanisms CIDSE advocates for priority to be given to mechanisms that internalise the cost of environmental damage of goods and services, realising a *'double dividend'* to discourage polluting actions. Environmental taxation such as a global carbon tax and taxes on various modes of transport are worth consideration among other financing mechanisms in this regard. CIDSE is currently working on more detailed recommendations on financing mechanisms in relation to climate change.

3.2 Limited responses to global challenges

In the face of such widespread challenges, the responses the world has given have been very limited. The commitment of rich countries, since 1970, to dedicate 0.7 per cent of their GDP to development aid, was a narrow one and has not even been honoured yet by the vast majority of rich countries. The two most promising avenues to provide adequate responses, global taxes and international governance on taxation are at a very early stage of development and need considerable political investment to be further built upon.

3.2.1 Global taxation

An early idea of the creation of global taxes was contemplated by the Catholic Church as far back as 1967 in the Encyclical *Populorum Progressio* which is part of Catholic Social Doctrine. *Populorum Progressio* suggested the creation of a World fund to finance the needs of the impoverished peoples. This joint responsibility would lead to a shift of power towards an equal partnership built on mutual trust and fruitful dialogue between richer and poorer nations if integrated into a policy of worldwide collaboration.⁸⁴ But it was first popularised by James Tobin in the 1970s, with his now famous tax on currency transactions, primarily aimed at combating speculation.

3.2.2 Currency transaction tax

In the 1990s, a growing social movement, including CIDSE and Attac since its very beginning, has been advocating in favour of a currency transaction tax (CTT) – the version promoted by Prof. Paul-Bernd Spahn. CIDSE has consistently advocated for a CTT convinced of its potential of realising a more equitable distribution of wealth and a more stable financial climate while at the same time raising revenues that would be dedicated to financing the MDGs.⁸⁵

CIDSE's key arguments for advocating the CTT's adoption are:

Regulation

The two-tier (two-rate) CTT model that Professor Spahn proposed, would enable cooperative action by the world community or even individual governments to better predict rapid speculative runs on currencies and moderate their effects while generating revenue for development. Thus, a currency transaction tax could contribute to the prevention of major currency crises, acting as a monitoring device

Re-pricing and redistribution

A tax on currency transactions would tap the large and fast growing share of financial markets in the global economy. Since the greatest volume capital that passes through the financial market is largely owned by entities with considerable disposable resources, such a tax would oblige them to some contribution for global development and provide for a fairer distribution of wealth between the rich and poor, in the North and South. It would also shift the tax burden from wages and consumption to capital thus making the overall tax system more equitable.

⁸⁴ *Populorum Progressio*, Encyclical of Pope Paul VI on the Development of Peoples.

⁸⁵ Ref. CIDSE website on actions on CTT, CIDSE paper. 2004, CIDSE paper on Innovative Resources 2005.

Revenue generation potential

Possible revenues depend on the rate and scale of introduction. Rodney Schmidt in 2007 estimated that a CTT of 0.5 basis points on the major currencies would yield an annual revenue of at least \$33.41 billion.⁸⁶ The revenue generated would need to be earmarked as additional (to the 0.7 per cent ODA) and directly supporting the achievement of the MDGs.

Feasibility

Many were sceptical about the feasibility of a CTT in the past and it has been the subject of serious debate. Over a period of time several studies have proved the feasibility of the CTT at a single low rate as a revenue-raising device (see following paragraphs on the Currency Transaction Development Levy). It was endorsed by the UNU-WIDER report in 2004, by the *Landau Report* sponsored by the French government, by the *Quadripartite Report* supported by Brazil, Chile, France and Spain and by the World Bank in 2004. While often global introduction was deemed necessary and seen as very unrealistic, publications have proved that it is feasible for a group of countries to implement a CTT e.g. the study by Bruno Jetin and Lieven Denys in 2006.⁸⁷

Political support for the introduction of a CTT has so far come from France, Belgium (legislation), and Austria (Government programme) while currently debates are underway in Japan.

Most recent studies such as “*A Euro solution*”⁸⁸ by the international financial advisory firm, Intelligence Capital Limited, confirm the possibility of a unilateral introduction of a CTT by any country or currency zone without major negative economic side effects or disturbances of the respective currency markets. These publications suggest a ‘*Currency Transaction Development Levy (CTDL)*’ with a very low rate of half basis point (0.005 per cent) and taxation based on all trade in a particular currency wherever they take place - not on jurisdiction as promoted by Spahn - to minimize market distortions or chances for evasion.

Highly conservative estimates of the likely annual revenue raised through the CTDL based on unilateral implementation at a rate of 0.005 per cent by the UK would reach \$2.08 billion, by Norway \$170 million and the Eurozone \$4.55 billion⁸⁹.

At the 2nd plenary meeting of the Leading Group on Solidarity Levies to Fund Development in Oslo in February 2007, the introduction of a Currency Transaction Development Levy (CTDL)⁹⁰ was proposed and gained much international attention. The Norwegian government planned to set up a task force to look into issues of implementation.

The first practical test of its implementation was done by INTL, a British private company, specialised in foreign exchange in May 2007. In a week-long trial, all currency transactions were taxed at a rate of 0.005 per cent. The company raised almost £4,000 in a few days, the proceeds of which were given to charity.

Whereas the model of a CTDL as promoted at the meeting of the Leading Group in Norway clearly focuses on the revenue-raising potential of the CTT, CIDSE insists that the regulatory potential of the CTT should not be lost in its implementation. Extreme fluctuations in exchange rates alongside the financial crisis bear a chance to bring regulatory aspects back into the debate.

⁸⁶ Schmidt, Rodney (2007), *The Currency Transaction Tax: Rate and Revenue Estimates*, The North-South Institute, Ottawa, October 2007.

⁸⁷ Jetin, Bruno and Denys, Lieven (2006), *Ready for Implementation* published by WEED, February 2006.

⁸⁸ Spratt, Stephen (2006), *A Euro solution*, Intelligence Capital Limited. Schmidt, Rodney (2007), *The Currency Transaction Tax: Rates and Revenue Estimates*, The North-South Institute, Ottawa, October 2007.

⁸⁹ Hillman, David, Kapoor, Sony and Spratt, Stephen, *Taking a next step – Implementing a Currency Transaction Development levy*, commissioned by the Norwegian Ministry of Foreign affairs.

⁹⁰ Based on Spratt, Stephen (2006), *A Sterling Solution: Implementing a stamp duty on sterling to finance international development*, a report for Stamp Out Poverty, Second edition © Stamp Out Poverty, September 2006, first published in November 2005.

3.2.3 Financial transaction tax (FTT)

The idea of introducing a general Financial Transaction Tax (FTT) rose out of recent developments in financial instruments beyond currency transactions contributing to financial instability. On the revenue side, the equal treatment of all financial instruments in this model, with its very broad tax base, allows for very low tax rates nevertheless resulting in substantial revenues.

Regulation function

A study by the Austrian research institute WIFO⁹¹ has argued that the expansion of financial markets, with the disproportionate growth of trading in derivatives (which makes up 80 per cent of financial transactions) has been considerably rapid as compared to the “underlying” markets of goods and services. The growing importance of technical trading systems in financial markets has significantly contributed to the volatility of asset prices. The cumulative effect of the consequent increasingly short-term transactions is rather destabilizing. Therefore the regulatory effect and a reduction of volatility is one of the main aims of the introduction of a Financial Transaction Tax (FTT).

The FTT as proposed would be levied on a whole range of financial transactions in the course of a step by step introduction covering all transactions with “financial assets”, spots and derivatives⁹² starting on organized exchanges at key financial centres with an expansion to Over-the-Counter (OTC) trading and broader geographical coverage in a next step. “Normal” transactions between customers (private as well as corporate) would be exempted. Proposed tax rates range between 0.01 per cent and 0.1 per cent.

According to the WIFO study an FTT as described above would have a regulatory effect thereby stabilizing excessive dynamic financial markets. As the tax base is the notional value of the respective transaction, this design implies that the tax burden relative to the cash invested grows as the leverage effect rises. Such an FTT will specifically hamper those transactions that involve high leverage and therefore a high risk. A general FTT would render transactions more costly the shorter their time horizon is, hence, it would tend to dampen technical trading. It can be expected to reduce excessive liquidity stemming from transactions which are very short-term oriented and might be destabilizing at the same time. Moreover a FTT could contribute to a small correction of the imbalanced tax load on ‘real capital’ and labour. Its regulatory effect on oil and food prices is currently studied given the high proportion of speculation in the recent price hikes⁹³. This would particularly benefit the poor.

Revenue-generation function

Potential revenues of a general FTT have been calculated for three tax rates, namely, 0.1 per cent, 0.05 per cent, and 0.01 per cent. Even though revenue estimates are based on the assumption that transaction volumes will be reduced by the introduction of an FTT, in North America and Europe, tax revenues should lie between 0.7 per cent and 2.2 per cent of GDP. This means even a tax at a minimal rate of 0.01 per cent within the EU would generate income of about \$103.9 billion per year i.e. about €82.7 billion or 2/3 of the EU budget.

⁹¹ Schulmeister, S., Schratzenstaller, M., Picek, O., *A General Financial Transaction Tax – Motives and Effects*; Study of the Austrian Institute of Economic Research (WIFO) commissioned by Ökosoziales Forum Europa and co-financed by the Austrian Ministry of Finance and the Ministry of Economy and Labour.

⁹² All spots and derivatives transactions on organized exchanges, e.g. trades of stocks and interest rate securities, as well as trades of futures and options related to stocks, interest rate securities, currencies and commodities.

⁹³ Schulmeister argues that oil price hikes cannot be explained by increased demand only. The increase of global demand on crude oil increased only by 1.2 per cent per year since 2004 compared to a price increase in the same period of 250 per cent. Trade with oil futures doubled since early 2006 and amounts to 530 millions of “paper barrels” - 6 times the global production of “real” oil.

Redistribution function

Transactions on exchanges are highly concentrated in financial centres in developed nations, within Europe; these are especially market places like London and Frankfurt. In fact the tax will effectively be paid by all actors who make use of the exchanges in these places. If one assumes that trading activities are roughly proportionate to the overall economic performance (i.e. nominal GDP) then a FTT might well be in line with the principle of a fair sharing of the tax burden. However, if the FTT serves the principle of redistribution, much will depend on the use of revenues which still needs further clarification. Presently, in Austria, the use of potential revenues from a FTT to finance its contribution to the EU Budget is being discussed alongside with its use to finance supranational challenges such as development cooperation.

Even if used to support global solidarity, decisions on the structure to administer the funds, their use and disbursement will be equally important to ensure a legitimate and representative set up where all actors can make their case on an equal footing and transparency and accountability are ensured.

3.2.4 Political recognition of the potential of global taxes

As touched upon briefly above in the discussion on the CTT, the idea of international taxes has been almost politically taboo. Much changed as a result of the decision of Brazil, France, Spain and Chile, in 2004, to join their efforts in exploring the feasibility of various international taxes in order to finance global public goods. Their so-called “*Quadripartite Report*”, as well as the *Landau Report* and numerous others in recent years have evidenced the technical feasibility of many international taxes. On the margins of the UN World Summit in September 2005 and despite strong opposition by various countries, 79 countries made a common call to further explore and experiment with the use of innovative mechanisms to finance development and global public goods, including international taxes. Since then a leading group of 53 countries has kept on exploring various possibilities and the consensus has been growing about the feasibility of most proposals – although obviously such a proposal as a joint additional corporate tax would require harmonisation of the tax basis. A pilot instrument, namely the tax on airline tickets that is levied at national level and coordinated at international level, was also launched in 2006. 18 countries now implement or soon plan to implement this initiative, including rich and poor countries, contributing an estimated \$500 million to fund the massive provision of medicines against HIV/AIDS under UNITAID.

There has been ample evidence in recent years that a rapid progress towards global taxation schemes is possible. The nomination of a special advisor to the UN Secretary General on innovative sources of finance, as well as the multiplication of calls for international taxes as regulatory instruments in the face of instable financial markets, can be interpreted similarly. At the same time, the road is still long before any truly global tax is created. The airline ticket is everything but a global tax and has evidenced the deep political opposition this idea would have to overcome – the US, for instance, has always rejected that the mere expression “international tax” is mentioned in an official international document.

3.2.5 The dawn of global tax governance?

John Christensen, Director of the Tax Justice Network, has compared the dawn of the tax justice movement in the last few years with the ecological movement in the 1970s. As seen in the preceding section, tax issues are only just being understood and are yet to be tackled in their global dimension.

A partly new global issue

The distribution of wealth as such is almost as old a problem as humankind is. It is quite clear for instance that tax injustice was at the very root of the decline of the Roman Empire. Salvien, a priest in Marseilles in the 5th century, indeed argued that the people had no incentive to fight for the Empire. Similarly, the French Revolution was largely due to raising discontent by the bourgeoisie who paid

significant taxes to the benefit of the tax-exempted nobility. The abolition of privileges, during the night of the 4 August 1789, was much fuelled by the protest against tax privileges.

Although inequalities among nations have dramatically increased in the last century as described in section 1 of the preceding chapter, they are an old concern as well. The mere expression “Third World” was coined by French geographer, Alfred Sauvy, after the ‘*Third State*’ of the French Revolution, i.e. the powerless majority. Proposals for a fairer world gained momentum after the Second World War and African decolonisation.

What is historically still quite new and has not been properly acknowledged is the globalised trend of tax injustice. Raymond Baker considers that the international financial system has evolved almost without being noticed: “*For the first time in the 200-year run of the free-market system, we have built and expanded an entire integrated global financial structure the basic purpose of which is to shift money from poor to rich. [It is] the ugliest chapter in global economic affairs since slavery...*”

The scale of tax injustice has changed in the face of globalisation, but it is striking how similar the issue is with the imbalance laying under the decline of the Roman Empire, as evidenced by the analysis of Salvien in the 5th Century:

*“Paying taxes is a pain, no doubt about it, but it is less of a pain if everyone bears their fair share of the tax charge. It is intolerable, however, when not everyone pays their contribution: and the poor end up paying for the rich. Worse still when the rich choose every now and then to raise the level of taxes, but the poor are made to pay for them. What a scandalous confiscation! A powerful minority deciding what the unfortunate masses must pay! Can you tell me amongst which races such a scandalous situation prevails: not amongst the Franks, nor the Huns, and neither amongst the Goths or the Vandals. One thing that amazes me, in these conditions, is that all the poor and the native peoples haven't simply switched sides to the Barbarians.”*⁹⁴

Institutional vacuum

As argued above, the globalised trend of tax justice implies that no state alone can address such challenges as the weakness of international tax cooperation, massive tax evasion, the collapse of customs revenues and interstate tax competition that is exacerbated by vested investor interest and by zero rate taxes charged by tax havens. The magnitude of this challenge requires a coordinated response at the international level.

The European Union and OECD have developed tools to combat tax evasion and harmful tax practices. These have not put an end to the problems, but they do represent a significant expertise and experience in this field. Yet, these organizations work primarily for their members, mostly rich countries. No global institution has been mandated to tackle these vital global challenges.

Forty years ago, the Economic and Social Council (ECOSOC) of the United Nations established an ad hoc group of experts, composed of 25 members, to develop international tax cooperation. In 2001, a UN Report written by a panel of experts led by Ernesto Zedillo pointed out that globalisation weakens the territoriality principle on which traditional tax laws are based and recommended the establishment of an international tax organization.⁹⁵ The report was supposed to inform discussions to prepare the International Conference on Financing for Development in Monterrey. Instead, the Financing for Development Conference, merely stated the need to “*strengthen international tax cooperation*”.

On the recommendation of Kofi Annan, the UN General Assembly in 2003 converted this group to an ad hoc Committee of Experts on tax issues, which meets annually in Geneva. It is meant to monitor

⁹⁴ Quoted in Jerphagnon, Lucien (2004) *Les Divins Césars. Idéologie et pouvoir dans la Rome impériale*, Ed. Tallandier, 2004, Paris, pp.481-82. Translated into English by John Christensen.

⁹⁵ United Nations (2001), Report of the High Level Panel on Financing for Development, New York - http://www.un.org/reports/financing/full_report.pdf.

the model UN tax treaty, to provide a forum for international tax cooperation, to address emerging issues and their tax implications, to help with capacity building of tax authorities and to pay special attention to developing countries. The committee comprises 25 experts, whose members are appointed by the UN Secretary General and reports to ECOSOC. Its members have no political mandate from their country of origin. This, combined with limited resources (only two persons supporting its work), explains why, in reality, the work of the committee has been quite technocratic, focusing mainly on tax cooperation treaties. This is an insignificant response to the global challenges at stake. The Financing for Development Review Conference in Doha in late November 2008, is an opportunity, as envisioned in the first draft of the Conference's outcome document, to upgrade this UN Tax Committee into an intergovernmental body with enhanced means to properly fulfil its mandate.

3.3 Conclusion

In the era of globalisation, like in other fields, tax issues have not been tackled yet at the appropriate – global - scale. Yet, two lessons may be learnt in the light of changing regulation in climate change as well as in international finance. On the one hand, and this is no mystery, global institutional responses appear to progress in the long run, although at a very slow pace. Ongoing discussions on the need for an international tax organisation and on international taxes show that the process towards strengthened global tax regulation is already on the way. On the other hand, tax has never been experimented as a regulatory tool at the global level, but the many deep crises our world has been facing may speed up the creation of such instruments.

IV. RECOMMENDATIONS

1 **Progressive and gender-sensitive national tax systems should be at the heart of democratic national development financing strategies combined with regional coordination**

Tax systems have to be tailored to respond to each national context, seeking out the right balance between, individual and corporate taxes, direct and indirect taxation, taxes on labour and wealth, exemptions, subsidies and broad inclusion in the tax system⁹⁶. Where they exist, harmful practices such as systematic tax exemptions in the form of tax holidays for TNCs for instance, should be ended and royalty regimes should be reviewed. These mechanisms significantly lower public revenues and public acceptance of taxes, while fostering corruption and providing very little benefit to the many Southern countries who adopt these practices to attract foreign investors. Redirecting windfall profits from currently high commodity prices could become an important source for financing national development plans as well⁹⁷. All in all a tax system should lead to a gradual build up of domestic resources based on just contributions according to the ability to pay and necessary regulatory effects.

On the other hand fiscal policy should be seen to be responsive to public needs. First and foremost, it should address the needs of the poor. It should also be designed to adequately finance expenditure for the provision of public services and social protection measures. Citizens who see the benefits provided through their tax contributions would gain faith in their government and probably be more supportive to taxation.

For CIDSE a just tax system⁹⁸:

1. **raises adequate revenues to pay for the public needs of society**
Taxes must raise enough revenue to promote the common welfare of the nation by enabling payment of current expenses and interest on debts from the past, as well as providing funds for future needs.
2. **is efficient and simple to administer**
Loopholes are eliminated and all pay their fair share. The complexities of the system are reduced. In particular, no exception is made for foreign investors.
3. **is transparent and democratically elaborated**
Tax policy must be debated in parliament as part of budgetary discussions and controlled by parliament. No exemption to the tax rule shall be agreed without the consent of the parliament. Information on tax policy must be public.
4. **is progressive**
People with greater financial resources pay a higher rate of taxes while the rates for middle and lower incomes are at levels proportionate to the income. Those at or below the poverty line are exempt from income taxes. Taxes levied at the same rate for all people are considered regressive in that they place a proportionately higher tax on those with lower incomes.
5. **redistributes wealth to make a more equitable society**
The foundation of distributive justice is the redistribution of income from those who are wealthy to those who are less wealthy. This is accomplished through the levying of progressive taxes and includes incentives that benefit the common good.
6. **offers incentives for behaviour which clearly benefits the common good**
Such incentives could include: tax credits for hiring those who are disadvantaged, education of low-income youth, home mortgages for low and middle income families, higher taxes on alcohol...

⁹⁶ See also examples given in Tax Justice Focus First Quarter 2007, Volume 3 Issue 1.

⁹⁷ SCIAF, ACTSA Christian Aid (2007), *Undermining Development? Copper Mining in Zambia*.

⁹⁸ Taken from NETWORK Education Program, *Learning About Taxes: Towards a Just and Fair System* - <http://www.networklobby.org/>.

2 Donors must support the building of or reinforce progressive national taxation systems

In the long run developing countries should depend less on aid resources but gradually build up and manage their own sources of income. This would first and foremost mean that countries should have the policy space to define their own tax policies suitable for their situation and the needs of their citizens.

For donors now concentrating on budget support to developing countries this would mean stepping up support to developing country in establishing transparent financial systems and accountable institutions and encourage participatory budgeting processes as well as gender budgeting. Although this has been on the agenda since the Monterrey Conference on Financing for Development in 1992, developing countries especially in Sub-Saharan Africa have faced major problems to move on from staggering and fluctuating national revenue due to volatile commodity prices, natural disasters affecting their agricultural outputs, unsuitable policies and income losses through tax competition or ‘leaks’.

Support could come in the form of research and analysis of tax systems including poverty and gender impact assessments, capacity building for institutions at central and lower levels. It could also include building capacities of governance structures such as Parliaments, courts of auditing as well as civil society to enable them to hold government to account and monitor financial systems.

Among ongoing initiatives to strengthen national taxation systems, the Pretoria Initiative initiated by South African Finance Minister, Trevor Manuel, with the support of the OECD is an important initiative. CIDSE believes that the Initiative should include a dialogue around such substantial issues as source versus resident-based taxation of TNCs.

Donors should also recognise and support South-South initiatives such as the South-South Sharing of Successful Tax Practices initiative. This initiative brings together a variety of organisations (UN Development Programme, UN Department of Economic and Social Affairs, Tax Justice Network and international civil society coalition, New Rules for Global Finance) plus professional practitioners from developing countries to share experience on specific issues, e.g. transfer pricing, information exchange, etc. It forms part of developing policy expertise to encourage participation in international policy processes such as the UN Tax Committee.

3 The international fight against tax evasion and competition should be made a development priority

Efforts to build up and sustain progressive taxation systems will be severely hampered if the international community does not work towards an enabling financial and economic environment that plugs the leaks of capital flight, tax evasion or competition and corruption. This will need at least as much attention of the donor community as direct aid. Limiting tax competition, tax evasion and the harmful operations of OFCs needs serious international cooperation on various levels including:

i. A greater role for the UN in the area of tax cooperation

For effective coordinated action an international tax authority is needed to ensure that national tax systems do not have negative global implications. As a first step the UN Committee of Experts on International Cooperation in Tax Matters should be upgraded into an Intergovernmental Committee based on political representation which would expand on existing international efforts, especially by the OECD. The mandate of its members must be of limited duration to ensure a rotation of the countries represented. Relevant international organizations, the private

sector and civil society must participate. Without being radically altered, the mandate of the committee should give priority to:

- producing reports, particularly on emerging issues and with special attention to developing countries⁹⁹.
- further work on the UN Model Tax Convention.
- the development, promotion and monitoring of a UN code of conduct against tax evasion and illegal capital flight. Monitoring should take the form of a review by both peers and experts, closely coordinating with the OECD, and focusing in particular on the application of international standards concerning information exchange and transparency.
- the production of recommendations concerning demand-driven technical assistance and capacity building for tax administrations in the South.

This upgrading should be accompanied by substantially more human and financial resources for the Committee to fulfil its mandate. Proposals for the creation of an International Tax Organization should be seriously considered.

ii. A code of conduct for states on cooperation in combating international tax evasion and avoidance

While international cooperation has improved on information exchange in the areas of money laundering, corruption, fraud, cross-boarder cooperation on tax evasion still remains very limited. Effective international action needs to be based on a multilateral agreement on common standards and mandatory and an automatic exchange of information. Only if information about taxable income of a citizen in another country is reported, can tax evasion be traced. The EU has made some progress with the European Savings Directive which foresees automatic information about interest payments to residents from other member states.¹⁰⁰ However, its scope is limited. It only relates to individuals' savings, which allows for many leaks. It should thus be extended to include all legal entities, including trusts and foundations. It would also need to be extended geographically, so that automatic exchange of information becomes a global principle.

The outcome of the Doha Financing for Development Review Conference provides a good opportunity for the international adoption of the principle of a UN code of conduct on combating tax evasion and avoidance including rules on transparency, exchange of information and establishment of legal instruments to which governments have to commit. The principle of such a proposal was adopted already by the UN Tax Committee and discussions on content are ongoing. Key elements of such a code should be:

- a requirement of transparency in financial matters that would, for example, limit bank secrecy rules.
- an agreement to exchange information on tax matters with other governments.
- a commitment to avoid the establishment of legal instruments that are intended to confound tax enforcement, such as trusts with undisclosed terms.
- conformity with emerging standards with respect to 'know your customer' rules for banks and other financial intermediaries and 'know your shareholder' rules for corporations and other legal entities.
- a commitment to adopt and enforce reporting rules, such as rules on large cash transfers.

iii. Strengthened judicial and tax cooperation

Besides corruption, money laundering or financing illegal activities tax evasion must be seen as a criminal act and handled accordingly. Legal prosecution needs strengthened judicial and tax cooperation between states. Strengthened judicial and tax cooperation should involve at least the following three elements:

⁹⁹ For example: the economic impact of transfer mispricing, the role of financial intermediates, tax competition, effective exchange of information, analyse the possibility to expand initiatives for the return of stolen assets to the product of tax evasion.

¹⁰⁰ http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm.

- An obligation to provide any bank information when required by foreign judicial and tax authorities on people suspected not only of corruption or misappropriation of public funds, but also of tax evasion.
- A renewed blacklisting of those tax havens which do not cooperate with foreign judicial and tax authorities. At their Paris Conference on 21 October 2008, 17 OECD member states required the OECD to do so by mid-2009. CIDSE supports this process, provided the black list effectively includes all states unwilling to give tax and judicial information, to abandon strict banking secrecy and to register trusts' beneficial owners, including major financial centres such as the US state of Delaware and the City of London if appropriate. CIDSE also requires that gradual and strong retaliation measures be taken against uncooperative tax havens.
- An obligation to repatriate stolen assets, as required by the UN Merida Convention against Corruption. CIDSE recommends its quick adoption and ratification worldwide and by 2010 at the latest in Europe and North America, including in their dependencies and overseas territories. A follow-up mechanism to the Merida convention should be created and the return of stolen assets should become compulsory whether or not the receiving state is able/willing to initiate judicial proceedings for their repatriation. CIDSE also calls for the possibility to expand the acceptance of the notion of "stolen assets" to the product of tax evasion.

iv. Limiting tax competition

By shopping around for the most conducive fiscal regimes, stimulated by free movement of capital, TNCs have amplified tax competition world wide¹⁰¹ thus eroding national tax systems.

A multilateral approach to set up a common standard to define a tax basis and to minimise tax avoidance and a race to the bottom would be one of the most effective responses. States at comparable levels of economic development and states geographically close to each other should cooperate to eliminate destructive elements of tax competition Harmonisation of tax basis and minimum rates for corporate taxation within the EU and in other regions could be a first step.

v. Generalising the legal responsibility of people promoting or undertaking tax evasion

The instructions to evade taxes are usually not given from tiny tax havens themselves but from large financial places such as Frankfurt, New York, London, Tokyo or Paris. Therefore, any action to fight against tax evasion should also aim at having financial intermediates, such as corporate directors, lawyers, accountants, responsible before the court for promoting or hiding tax evasion.

In the view of CIDSE, this first requires the generalisation of tax evasion as a criminal offence in every country and not only an administrative problem – this would be a major shift in particular in Switzerland. CIDSE also calls for the quick implementation of the EU 3rd anti-Money Laundering Directive and the inclusion of tax evasion under anti money-laundering legislation. Anti-money laundering efforts should also be enhanced in developing countries, including by the strengthening of regional FATFs and by providing them with constraining power.

vi. Underlining the responsibility of the International Monetary Fund (IMF) for the monitoring and surveillance of financial centres and the international financial architecture

To fulfil this responsibility the IMF in its Reports on Observance of Standards and Codes (ROSCs) should report on compliance of jurisdictions that are financial centres handling assets on behalf of non-resident clients with standards of international financial transparency and effective exchange of information.

¹⁰¹ See also Killian, S. (2007), *The dangerous game of tax competition* published in Village.ie, 5 July 2007 - http://www.village.ie/Ireland/Government/The_dangerous_game_of_tax_competition/.

vii. Supporting vulnerable economies in moving away from tax haven status

Small countries, often isolated and lacking economic alternatives, have chosen to become tax havens as a way to economic prosperity. Some small economies may depend on their offshore business for as much as 20 per cent of their GDP.¹⁰² Such countries, where the poorest often do not take any advantage of the offshore status, need support to diversify their income and comply with standards to prevent money laundering, including financial assistance to be able to stop acting as tax havens. CIDSE recommends international support to facilitate the reconversion of isolated offshore centres into other economic activities.

4. A range of measures must be taken to enhance the transparency of revenues of TNCs

For countries with weak tax systems, taxing entities that are part of large business operations poses considerable difficulty. Exploiting loopholes, transfer pricing and shifting profits to low tax areas or OFCs are key practices of TNCs to avoid taxation. Additionally, regulations by northern countries such as tax and banking secrecy and the lack of an objective accounting standard limit host countries' capacity to establish a clear picture of companies' earnings.

Extractive Industry Transparency Initiatives

The EITI – Extractive Industry Transparency Initiative – is one step in the right direction. This multi-stakeholder initiative developed as a result of pressure from the Publish What You Pay (PWYP) campaign, but it also helped distract attention from it.

In reality, both the EITI and the PWYP approaches (which are, in institutional terms, inter-connected) have great merit: the EITI is progressing and is delivering better transparency in a number of countries, while PWYP's mandatory approach is more all-encompassing but has faced much higher political obstacles. Nevertheless, recent progress in three processes is worth noting:

- Following lobbying from civil society organisations, including PWYP and Tax Justice Network, the European Parliament approved a motion submitted in November 2007 requesting the European Commission to “*go beyond voluntary guidelines and support the development of an appropriate accounting standard requiring country-by-country reporting by extractive companies.*”¹⁰³ More work is to be done, but this represented a check to the International Accounting Standards Board (IASB) which had opposed country-by-country reporting. Much of the lobbying has concerned an accounting standard known as IFRS-8 (International Financial Reporting Standard-8) which concerns which “segments” companies must report on.
- In May 2008 US Senator Barney Frank introduced legislation HR 6066, the Extractive Industries Transparency Disclosure Act (EITD),¹⁰⁴ which will require companies listed on U.S. stock exchanges to disclose certain information including aggregated payments to governments on a country-by-country basis. The legislation is still to be approved, and it only covers some payments (e.g. it excludes profit and cost data), but it represents progress.
- This is all accompanied by growing international interest in grassroots mobilisation on transparency issues. In Gabon, for example, local activists attached to the PWYP coalition criticised a secretive multi-billion dollar iron mining deal signed with Chinese companies, apparently at terms highly disadvantageous to the country. Protests at the secrecy and terms of the contract were followed by a renegotiation on better – though still disadvantageous – terms. In Bolivia and Ecuador, grassroots' involvement in the terms of energy deals have significantly shifted the political weight against foreign oil companies, sometimes resulting in renegotiation.

¹⁰² Oxfam GB (2000), *Tax Havens: Releasing the Hidden Billions for Poverty Eradication*, Policy Paper.

¹⁰³ <http://www.europarl.europa.eu/sides/getDoc.do?Type=MOTION&Reference=B6-2007-0437&language=EN>.

¹⁰⁴ http://www.house.gov/apps/list/press/financialsvcs_dem/press051908.shtml.

Extending transparency to other economic sectors

Beyond the extractive sector, three avenues are worth promoting to foster transparency in all economic sectors:

- The debate on international accounting standards opens a significant opportunity to foster transparency. Country by country reporting could thus be made applicable to all industries, including of course banks, pharmaceutical companies, and all the others subject to international accounting standards. If country-by-country reporting could be applied to International Financial Reporting Standards, it would capture almost all of the world's major multinational companies and would amount to a revolutionary step forward for international financial transparency. There have been promising advances in this direction. In September 2008, major investors expressed their support for this proposal at an IASB meeting. This shift would have major impacts on developing countries by achieving two main things. First, it would enable developing country governments to understand much better the tax positions of the multinational companies operating in their territories and tax them more appropriately. Second, it would provide citizens of their countries with a wealth of new information to enable them to call their leaders to account. If this could be achieved, it would be enormously powerful: more than 100 countries now use, or are adopting, International Financial Reporting Standards, including all 27 European Union members, China, Japan, Canada and India. In August 2008 the US Securities and Exchange Commission (SEC) presented a "roadmap" for US companies to use as they migrate from US accounting standards, the last significant accounting standards to be switched, to IFRS.
- Although the current trend towards taking sanctions against uncooperative tax havens, as identified on the OECD black list, is a welcome move, it would miss the point if it did not target also the key users of tax havens, including banks and trans-national corporations. CIDSE calls for sanctions to be taken against the companies which maintain subsidiaries in uncooperative tax havens and which refuse to provide details and explanation of their links with those territories. Such sanctions could include prohibiting access to public procurement, public export credit and even access to the stock exchange.
- The creation of an international trade register – or at least regional registers, in particular at the EU level – in order to keep track of all created companies and legal entities, especially special purpose vehicles (SPVs) and trusts, including the name of shareholders and/or beneficial owners. This would much facilitate the work of tax administrations and the judiciary and would contribute to end the phenomenon of shell companies.

5. Global taxes must be adopted as a viable response to scale up redistribution and respond to emerging global challenges

As outlined in the first section of this paper, the design of global taxes has to be critically examined against the 5 R's: Revenue, Redistribution, Regulation, Re-pricing and Representation. Chapter 3 argues that in the current context, global taxations such as the CTT or the more general FTT have the potential to fulfil at global level such key functions as revenue raising, regulation, redistribution and re-pricing. Global taxes in today's context could hardly serve representation functions unless there is some kind of a global government. This does not exist, but the creation of international taxes for other reasons would probably accelerate the much needed strengthening of democratic global institutions with some sense of representation.

Using the revenues from international taxes for financing development and global public goods should be considered complementary and additional to existing sources of development finance. Along with increasing the amount of resources available and ensuring predictability of resources flows, stepped up resources would more effectively be able to support development countries' in their own efforts to raise revenue, strengthen financial administration and spending for poverty eradication.

CIDSE calls on any state willing to do so or the Eurozone countries within the European Union to introduce a pilot CTT. Any further debate or study on international level should concentrate on the

details of its implementation. A simple stamp duty on foreign currency transaction levy to finance development needs as the proposed CTDL could be a first step to get it off the ground and gain experience in implementation.

However, CIDSE believes the regulatory part of a CTT should still remain a long term objective. This could be put in place through the second tier based on the Spahn model or in a form that has been further developed towards a more general tax on financial transactions.

CIDSE also welcomes the idea of a general FTT. As the FTT is a new mechanism, CIDSE suggests that international fora such as the Leading Group on Solidarity Levies to Fund Development and the process leading up to the Doha Financing for Development Review Conference should be used for further discussion and promotion of a Financial Transaction Tax. CIDSE particularly encourages the EU to undertake a first test on the practicability of a FTT.

Representative democratic governance and administration of global taxes

Presently taxation is based on national legislation and tax collection is in the responsibility of each individual country. As there is no international authority to take on any tasks like this, taxes will be collected by national channels and either used according to international agreements or at best pooled for a joint use. In this way resources for much needed tasks in international development for global public goods or to address global challenges can be raised. Using existing channels might also appear as an efficient solution. But inappropriate power structures will be perpetuated as decision-making on the use of resources will remain at the discretion of rich nations while real partnership and joint responsibility will continue lacking. In order to address this, international governance architecture to govern global taxes should be established when sufficient momentum in this area has been established.

While a detailed proposal for a possible form of international governance architecture is beyond the scope of this paper, CIDSE suggests the following principles to be taken into consideration its design:

- Binding mechanisms should be agreed upon in the form of multilateral agreements or treaties to guarantee long term commitments and predictability.
- To ensure representation, equal decision-making and joint ownership by all actors the process from taxation to administration and spending has to be integrated into a multilateral setting which guarantees equal rights and participation of all stakeholders, transparency and accountability.
- The UN should play a key role to generate a consensus on international taxation and to put in place the new governance architecture for international taxes.
- In the context of the current debate on financing global public goods, financing structures complementary to traditional channels of funding for development should be further explored including questions of additionality, complementarity and coherence of '*vertical funds*'.
- The UNITAID structure, designed to provide an equal forum for representatives from various stakeholders such as governments in North and South, civil society, specialized organisations and international funds, provides an interesting test case from which lessons can be drawn. Critics of UNITAID have questioned the new structure for its aid effectiveness, pragmatism and limited focus on the health sector where a lot of different actors are presently already involved. It should be closely monitored and evaluated especially with regard to the participation of stakeholders based on principles of equality and ownership at the local level, implementation and impact on the ground in order to draw lessons learnt for structural solutions in the future.

CONCLUSION

The capacity of a state to fulfill its obligations towards its citizens is, to a great extent influenced by the nature and volume of the resources put at its disposal for public expenditure.

External financial assistance remains a critical factor for many developing countries, particularly in immediate action to meet the MDGs. Industrialised countries need to spend at least 0.7 per cent of their GNI in financial assistance to countries without sufficient means to achieve them. This assistance should be an actual transfer of resources and not be inflated by other expenditures.

Yet, one cannot ignore the fact that in the last decade, with the onset of almost unbridled globalisation, there has been a net transfer of financial resources from poor to rich countries rather than in the other direction. Debt servicing, revenue loss from trade liberalisation and foreign currency reserve build-up are critical in this regard and need to be tackled. However, they do not account for all of the flows from South to North. Illicit capital flight, whether through transfer of stolen assets, tax evasion or other illicit activity account for a major share of these flows. In the current debate on financing for development, these issues have not been paid their fair share of attention. While considering the significant impact of globalisation on poverty and injustice in this paper, CIDSE believes that globalisation has also created opportunities for renewed action to address these problems given their global magnitude.

At the same time, we are convinced that the financing for development agenda should be more than a mere needs-fulfilment exercise. As an international network of Catholic development organisations advocating for wealth to be distributed equally within and among countries, CIDSE considers that taxation should be at the heart of development finance. The key to this are the five 'R's of Revenue, Redistribution, Regulation, Re-pricing and Representation that summarise the role of taxation. From this perspective, CIDSE feels that priority should be given to efforts at national level to broaden tax bases and strengthen fiscal administrative capacity. International finance, support and systemic reform remain equally crucial to support national efforts in this regard. The international fight against tax evasion should be made a development priority.

Additionally, CIDSE recommends the development of international taxes. Such taxes have become necessary thanks to globalisation that has increasingly connected the world; it has also made revenue, redistribution, regulation, re-pricing and representation on a global-level more necessary than ever before. CIDSE particularly advocates the adoption of a CTT, or a more general FTT along with a host of other environmental taxes that are urgently needed to address the specific demands posed by the rapid and damaging consequences of climate change.

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